S. HRG. 101-713

RTC REPORT ON FSLIC'S 1988–89 ASSISTANCE AGREEMENTS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE REPORT BY THE RTC ON THE 1988 DEALS THAT WERE DONE TO TRY TO RESOLVE FAILED THRIFTS PURSUANT TO THE FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989 [FIRREA], THE RTC WAS CHARGED WITH INVESTIGATING THOSE DEALS ARRANGED BY THE FSLIC TO DETERMINE WHETHER COST SAVINGS COULD BE REALIZED BY RESTRUCTURING THE DEALS ACCORDING TO THE PROVISIONS THAT WERE ACTUALLY CONTAINED IN THE CONTRACTS

SEPTEMBER 20, 1990

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RTC REPORT ON FSLIC'S 1988–89 ASSISTANCE AGREEMENTS

THURSDAY, SEPTEMBER 20, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:30 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr., (chairman of the committee) presiding.

Present: Senators Riegle, Garn, Shelby, Wirth, Graham, Bond, Bryan, Kassebaum, Dixon, Kerry, Sanford, and D'Amato.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me welcome all those in attendance this morning. We will begin the hearing today.

This is an important hearing. We are pleased to have Chairman Seidman back with us again.

Today's meeting will focus on the report by the RTC on the 1988 deals that were done to try to resolve failed thrifts.

Pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [FIRREA], the RTC was charged with investigating those deals arranged by the FSLIC to determine whether cost savings could be realized by restructuring the deals according to the provisions that were actually contained in the contracts.

The second part of the report, which the RTC should be able to present shortly, will investigate and lay out the facts on the fairness of the bidding process that was used by the FSLIC in those 1988 deals.

It is very important to note that members of this committee have long been concerned about the deals that were negotiated late in 1988.

On October 20, 1988, I and Senators Graham, Wirth, Chiles, Proxmire, and Sasser wrote to the GAO and asked for a formal review of these transactions.

I will not go into the history of what followed that, but the GAO went to work on that.

That was followed by a second letter that I sent to the GAO on December 30 when there was a flurry of activity just before the end of the year with some large deals still up on the air to ask the GAO to get involved at that point so that we had a way of understanding exactly what was taking place.

In addition, at that time some of my colleagues were also expressing a concern about it.

I called Secretary of the Treasury Brady who at that particular time, at the end of 1988, was out of the country but I managed to find him and we talked.

I asked him at that point if he could get involved himself as Treasury Secretary and take a look at these deals that were pending, because I could see tremendous tax implications and tremendous revenue loss based on the tax concessions based in these deals.

The Treasury Secretary listened carefully to what I had to say.

He also I know received a telephone call at that time from Senator Metzenbaum on that same issue, because Senator Metzenbaum and I had both been discussing it with one another.

The Treasury Secretary said he would think about that. He did for a day or so and called me back and indicated that, upon reflection, I assume talking with the legal people in his shop, he felt that he did not have the basis upon which to inject himself into the proceedings at that time and decided that he could not do so.

In any event, there is a history here of which these requests to GAO and requests to the Treasury Secretary are only a part.

I think it is troublesome that without prior authorization by the Government that one Government agency could commit the United States Treasury to expenditures of roughly $70 billion, and that is in fact what took place, as this report laid out.

For the future we will have limited the ability of the RTC to make such large expenditures by placing a note cap on the obligations that are issued by the RTC.

In reviewing the 1988 deals, I have three primary questions:

First, is there anything that can now be done to save the taxpayers money?

Second, were any of the parties that bought the failed thrifts unjustly enriched and given some special advantage in the negotiating process?

Third, was the bidding process fair and open?

Now the cost of a bailout has been a key concern of mine since FIRREA was first introduced by the administration in February 1989.

I will ask Chairman Seidman today to tell the committee whether there is any specific action he recommends that the Congress take action on between now and the end of the session to get the funds to refinance the FSLIC notes and, if so, what specific suggestions he might have to present to us.

I also noted that in your testimony on the House side that you have indicated that, both with respect to future close-downs and working capital, it looks like you need about $100 billion soon.

So I am going to ask you to elaborate on that today, too, so that we have a clear understanding of what that cash flow need is, so we can consider how that might be done.

Also, there have been reports that some parties had unfair access to the bidding on the 1988 deals.

Part of the legislative mandate of FIRREA is for the RTC to reveal the 1988 deals and make "such recommendations for legislative action as the corporation may determine to be appropriate."

So the law I think is very clear. If there is specific legislative language that is needed and recommended, then we would like to have it, and we will move ahead with it.

Now Chairman Seidman's prepared testimony indicates that the taxpayers could be saved a minimum of $3 to $4 billion with renegotiation of some of these contracts.

There are others who have suggested that still higher savings might be realized.

I think we ought to save every amount that we can and let the experts debate among themselves how much that might be, but whatever steps are available to us to shrink the cost of this situation I think ought to be taken.

It seems to me that Chairman Seidman's report today is a road map to some of the savings that can be achieved here.

According to the contractors who put this report together, the easiest thing to do is to refinance $11.3 billion in FSLIC notes that were issued in the 1988 deals.

I want, Mr. Seidman, your specific thoughts on whether you think that refinancing ought to be done to pick up that particular savings, and whether there are other things that could be done expeditiously to save money, which we should also undertake to do.

I am going to call on Senator Garn, and then I will call on my colleagues.

Senator Garn.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you very much, Mr. Chairman.

Chairman Seidman, whenever the Government spends money obviously the people have a right to know about how it is spent, and whether it is spent efficiently, and to account for it.

When one comes to the large sums of money that we are talking about, certainly that responsibility becomes proportionately greater.

I am glad that we finally have this report finished that was mandated in FIRREA.

As everybody can see, it is rather large and it cost $3.5 million. It is in seven volumes and three feet high.

It is a 2,721 page report on the 1988 FSLIC Resolution.

By saying that, I am not being critical.

I do not want anybody to mistake my meaning, because I think a very thorough and careful job has been done. I would just hope, though, that we look critially at the past—I have been around here for 15 years being very critical of a Congress that will not deal with comprehensive restructuring.

Unfortunately, one of the bad side effects beyond the enormous cost and the trouble the S&L crisis has caused us, we still are not doing anything about looking at an industry that in many ways is outmoded; time after time in the last 15 years we have tried to pass legislation. The last time was in 1988 under Chairman Proxmire's leadership, with only two negative votes—90-some-odd votes to 2—in favor of a bill addressing the structural problems of the whole financial services industry.

We still have not done that because the House of Representatives, time after time after time, has refused to take the Senate's lead.

In 1984 I think it was 95 to 5 we passed restructuring. Besides learning about the specifics of the past, I would hope we would start looking to the future and, rather than just playing catch-up, look at the pace of events in the financial markets into the future and be ready for that future so that our institutions are competitive not only domestically but internationally as well.

As I say, this report is very helpful. It is thorough, and it is balanced. It is not as helpful in terms of savings for the Treasury as some might have hoped or predicted.

It is, however, about what one would have expected except perhaps for some of those who seem to make a career out of demoguing bank and S&L issues.

There are very few surprises in the report. There is nothing sensational. The lack of reason for that sensationalism is well documented.

There is little surprise that savings can be found by prepaying FSLIC notes. FSLIC used at the time what few tools Congress was willing to provide after years of delay.

I would hope that the Chairman would take advantage of these and other similar unilateral Government savings options that were provided for in the FSLIC agreements.

When you add it up, the report concludes that between $2.2 and $2.3 billion in cost reductions might be obtainable.

That is a significant amount of money. At least in Utah, $2.2 to $2.3 billion still adds up to a lot of money.

But on the other hand, overall that is only about 5 percent.

Again I think in fact the report is very useful and helpful. We should restructure, pay off the notes, and do everything we can to save as much money as we possibly can.

Nevertheless, it is not the huge situation that many people have tried to portray.

Again, I thank you and your agency, Mr. Chairman, for a good piece of work. Anything we can do to help save that $2.2 to $2.3 billion I am sure the whole committee would do in order to be of assistance.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Senator Shelby.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

Chairman Seidman, something that seems to be out in America is that there is a perception that there were a lot of sweetheart deals here, a perception that the taxpayer is going to take a big hit on all these deals.

We read about them. You know, we have not examined them like your accounts have there, and perhaps your immediate staff, but there is a feeling in this deal that there were some deals made probably that would not stand the test of sunshine, and that there is a lot more money to be saved that the $3 billion figure.

That is something I do not know, but you know this from your vantage point that the American taxpayer feels strongly about the savings and loan problem.

It is going to grow. It is not going to go away. It is going to be with us a long time.

When they see and read about sensational stories of X person making hundreds of millions of dollars, whether it is true or not I do not know, about of this deal—some may be worth a billion or so—they wonder where we were, where the regulators were when these deals were being cut.

If they are those kinds of deals, I believe they ought to be looked at, scrutinized, and reopened.

I think that is what you are going to be here today to tell us.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Bond.

OPENING STATEMENT OF SENATOR BOND

Senator BOND. Thank you, Mr. Chairman.

It is always a pleasure to have you join us, Mr. Seidman.

We have in the past I think suffered from a lack of public understanding and attention to the problems in the financial institutions and the savings and loan industry, as well as the banking industry.

I believe we have cured the problem of lack of attention.

Some of the attention that we now receive is I am afraid in some instances a bit out of proportion, and we have certainly welcomed the discussion you had with us recently when you talked about the importance of the role of supervised management.

I noted in the paper today some concerns expressed by the General Accounting Office. They once again followed the practice of including interest costs in the future of the savings and loan bailout which I think is a disservice because it distorts what is already a very large problem and makes it more difficult for us to get a handle on it.

I also read with interest their concern with the National Bank of Washington that the regulators delayed too long in closing that down.

As I read a little bit about that and talked with people who were involved, I wonder if that was not a case in which supervised management or intervention earlier might not clearly have been appropriate? Supervised management might have avoided the ½ billion dollar problem that that is going to cost.

I have heard reports that perhaps a lack of coordination among regulators was responsible for what could have been a problem that could have been solved at relatively small cost and became a massive failure, one which I understand was a $35 million problem when the bank had about $150 million in primary capital that, by the way it was handled, became a $½ billion problem.

I think clearly there is no easy answer to handling the resolution of a sick institution.

Congress has been criticized for its efforts to seek forbearance. Regulators have been criticized for exercising forbearance.

But I believe in your discussions with us last week you gave us some good reason to evaluate more carefully the role that supervised management could have.

Clearly this is not a good time to be going into the market with massive real estate sales if we do not have to have them.

I would welcome your thoughts on that, and certainly I look forward to your testimony about this report. We have an extremely difficult problem, and your guidance is going to be very helpful to us as we seek to resolve it.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bond.

Senator Wirth.

OPENING STATEMENT OF SENATOR WIRTH

Senator WIRTH. Thank you, Mr. Chairman.

Mr. Seidman, thank you for being here. We appreciate your dedication and good work.

This report is dealing with cost savings. We are also very interested in the November report.

I believe there is another report coming behind this that deals with the bidding and negotiation process which goes to Senator Shelby's question.

That is where many of us, I think, believe that there were probably a number of sweetheart deals done at that time.

To go to the savings issue, you testified I understand before the Ways and Means Committee that we could save—if we spent, or had, $20 billion—we could save $3 or $4 billion. Do you have that money? What authority do you need?

It has also been reported that you are going to need about $60 billion more in terms of covering failures.

Do you have that money? If not, what authority is the administration going to request for this? The weak economy was discussed on the front page of The Washington Post this morning, and that is going to contribute more to the costs.

Do you have that money? Or do you need further authority?

Finally, I note from press reports the need for further working capital by the RTC. If you need that, do you have the authority to acquire that capital?

I think the Chairman and others have asked you, and I know I have been very interested in this, as well as others on the committee, as to what the administration's strategy is going to be.

What did you recommend to the administration?

What are they going to come up and ask us for? Do they want a blank check? Are they going to come up and ask for a finite amount of money? Are they going to come up and ask us for funds before the middle of October when the Congress is going to be gone?

What happens if they do not, between the middle of October and the middle of January? I hope you have a chance to give us your wisdom on that.

We are getting right up to deadline on all of this, and the administration so far has not come forth with what their request is going to be.

The Chairman asked the administration what they wanted, and it is my understanding they came back with a list of the options for that, but no indication of what it specifically wants and needs.

So while you are here this morning I hope you have a chance to address that issue, as well.

You already have a full plate, and I appreciate that, but you are a man that we all respect whose candor and integrity is impeccable.

We go to the right source for the answers to the tough questions.

Thank you again for being here and for your commitment to this very big job.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wirth.

Senator Graham.

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. Thank you, Mr. Chairman.

Mr. Chairman, I have an opening statement filed on an issue that I hope we can get into as to the similarities of what is happening in the fall of 1990 and what happened in the fall of 1988, which is the subject of your report today.

It was 2 years ago this month before the House Banking Committee that the then-Chairman of the Home Loan Bank Board made the statement, "I believe that in the past year the FSLIC has made significant strides in resolving FSLIC cases and, though subject to the vagaries of future economic conditions, realistic projections today"—that is, September 8, 1988—"indicate that FSLIC possesses adequate resources in the near-term to deal effectively with the immediate problems of troubled institutions."

That was the predicate upon which we moved into the fall of 1988, the period in which these transactions were made.

My concern is that we have heard some similar representations relative to the FDIC fund as we enter the fall of 1990.

So some questions that I would like to engage in will be:

What are the lessons that we should learn from 1988 to apply to 1990?

And based on those lessons learned, what should we be doing now relative to the FDIC fund that we were deflected from doing in 1988 relative to the FSLIC fund as a consequence of these what now appear to be wildly overly optimistic statements?

[The complete prepared statement of Senator Graham follows:]

PREPARED STATEMENT OF SENATOR BOB GRAHAM

Mr. Chairman, my interest in the 1988 deals has been to discover the impact on the American taxpayer and the Federal Savings and Loan Insurance Fund [FSLIC] as well as to the individuals who participated in the deals at all stages.

One of my particular interests was the bidding process used by the FSLIC to arrange assistance for these institutions. During 1988 many concerns were raised by individuals who wanted to bid on failing savings and loans and were frustrated by the actions of the FSLIC who made bidding on these institutions difficult by not providing information and apparent communication voids between the FSLIC staff and the Federal Home Loan Bank Board.

I look forward to Mr. Seidman's review of the 1988 deals and his recommendations on whether to restructure them.

The CHAIRMAN. Thank you, Senator Graham.

I must say, I am very pleased to see Senator Bryan here. He is working on the CAFE amendments. [Laughter.]

I breathe a little easier when I have got him in my line of vision. Senator Bryan.

Senator BRYAN. Mr. Chairman, I appreciate those comments. You might be less pleased if you knew what I had been doing for the previous hour. [Laughter.]

Senator GARN. Somebody from Nevada with those large, large distances to drive should not be doing that.

Senator BRYAN. We will have a chance to discuss that, Senator Garn, probably next Monday.

I am sure the Chairman of this committee has some interesting amendments for us to consider and debate.

Senator GARN. I agree. That is a good place to debate it.

I just want the Senator from Nevada to know that the Senator from Utah, with large distances to drive, is in favor of the amendments from the Senator from Michigan.

Senator BRYAN. I appreciate that. I hope to be able to debate and enlighten the Senator from Utah on Monday.

I do not have an opening statement. Thank you.

The CHAIRMAN. Thank you, Senator Bryan.

Fortunately, we have such good relationships around here that we can disagree on some issues and do it amiably.

Chairman Seidman, we are very interested in your assessment of this report and your sense of the bottom line here for what we can save and what we need to try to do.

We will make your full statement a part of the record, and I would like you to go ahead and make your presentation now.

STATEMENT OF L. WILLIAM SEIDMAN, CHAIRMAN, RESOLUTION TRUST CORPORATION, WASHINGTON, DC

Mr. SEIDMAN. Thank you, Mr. Chairman. Good morning to you and to members of the committee:

We appreciate this opportunity to testify on the Resolution Trust Corporation's Cost Evaluation and Cost Reduction Review of the 1988 Assistance Agreements.

The bottom line of our review is that the 1988 Agreements were a high-cost method of taking over insolvent thrifts, and thus billions can be saved by exercising options in these contracts.

However, to be able to achieve these savings, buy-out funding must be available.

As you know, FIRREA provided that the RTC was to evaluate the contracts entered into by FSLIC and the various acquirers with a focus on two principal goals:

In keeping with its contractual obligations, are there savings that can be secured by the Government?

And, two, was the contracting process fair and competitive and in every way legally binding?

The report, issued on September 18, which is up on the podium next to the Chairman, addresses the use and costs associated with each of the more common types of assistance granted by FSLIC and provides an evaluation of the savings to be achieved by exercising options available in the contracts.

I would like to emphasize that we are looking here only at options provided in the contracts. There is an important thing to be noted.

Not all the contracts have the same options. Some of the contracts have practically no options here. So whatever costs are built into those contracts cannot be saved by exercising options on the contracts.

A second report will be made in November which will focus on the issue of fairness, competitiveness, and the legal status of the contracts.

This first RTC report analyzes the agreements and determines what opportunities exist within the agreements to reduce the cost to the Government.

The committee has been of course provided with a copy of this report.

The report resulted from a review that was conducted by five private-sector groups under the direction of the RTC staff.

I might say, these groups were chosen by open competitive bidding. These groups included public accounting firms, law firms, investment bankers, consultants, and a public policy research group.

Each group reviewed one or more of the 96 FSLIC assistance transactions.

Based on the reviews conducted, the RTC estimates that the total payments by the Government on the assistance agreements will exceed $69 billion over the expected life of the contracts. I might say that that is total payments with interest, and all dollars actually paid out.

This figure assumes that no changes are made in the terms of the present agreements, and that no unilateral rights to reduce costs are exercised.

A significant portion of the costs represents interest expense that could be reduced if the Government expended funds now to prepay notes and to reduce the amount of assets covered by yield maintenance agreements.

The report identified certain areas where outlays from $18 to $20 billion in the 1991 fiscal year, and the exercise of future not prepayments and the other options listed below could achieve savings in the area of $2.5 billion. These are: Prepaying approximately $11.3 billion in promissory notes in 1991, and at the earliest opportunity thereafter.

With these payments, the Government could save as much as $1.2 billion in interest costs and tax subsidies.

Payment of approximately $3.8 billion for the write-down to market value of covered assets in 1991 could save $535 million in yield maintenance costs and tax subsidies.

Savings of approximately $520 million could be obtained if New West Federal Savings in Stockton, CA, fully exercises its prepayment options over the next several years on its $8 billion intercompany note with American Savings Bank.

While the Government is effectively paying itself for $4.9 billion in notes held by the Government-controlled institutions, those are institutions that were put together but never sold to the private sector.

Prepayments would provide the institutions with cash to pay off their high-cost borrowings, essentially brokered deposits and the like, and save an estimated $40 million a year, or a total of $300 million over the life of the agreements. We have attached to my testimony a chart that summarizes the potential cost reductions just described.

There are other cost-reduction opportunities that have not been quantified in the attached table that could result in substantial additional savings.

These savings relate to selected asset purchases out of covered asset pools. It is estimated that selected asset buyouts and other renegotiations relating to covered asset pools could result in additional savings of $1 to $2 billion in excess of the $2.5 billion I have previously mentioned.

Additional cost reductions also may be secured by a change in the current interpretation of the tax treatment of the deductibility of built-in losses.

Appendix No. 5 to our report discusses the ability of acquirers to deduct built-in losses when a covered asset is repurchased by FSLIC or the FDIC for an amount equal to the taxpayers' base, and the acquirer is fully and directly compensated with FSLIC capital loss coverage.

If this so-called "double dipping"—that is, deducting a loss and receiving tax-free compensation at the same time—is disallowed, the savings to the Government could be significant.

All of these findings, together with the remainder of the attached report will be presented to the RTC Oversight Board this afternoon for their guidance.

The committee should be aware, however, that the Office of Thrift Supervision has determined that the employment of all prepayment options may threaten the viability of a number of the institutions.

As a result, the report noted that the cost of the potential failures needs to be considered when assessing the potential savings. I think overall a fair result for both the Government and the contracting parties could be achieved by a renegotiation of these contracts reflecting the potential use of the options possible under the contracts.

Thank you for the opportunity to report to you. I will be happy to try to answer any questions.

[The complete prepared statement of L. William Seidman follows:]

TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN
RESOLUTION TRUST CORPORATION

ON

REVIEW OF THE 1988 ASSISTANCE AGREEMENTS

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

10:30 A.M.
SEPTEMBER 20, 1990
ROOM SD-538
DIRKSEN SENATE OFFICE BUILDING

Good morning, Mr. Chairman and members of the Committee. We appreciate this opportunity to testify on the Resolution Trust Corporation's cost evaluation and cost reduction review of the so-called '88 Assistance Agreements.

The bottom line is that the 88 Agreements were a high cost method of taking over insolvent thrifts and thus billions can be saved by exercising options in these contracts. To be able to achieve those savings, "buy out funding" must be made available.

FIRREA provided that the RTC was to evaluate the contracts entered into by the Federal Savings and Loan Insurance Corporation and the various acquirers with a focus on two principal goals:

1. In keeping with its contractual obligations, are there savings that can be secured by the government; and
2. Was the contracting process "fair" and competitive?

The report issued on September 18 addresses the uses of, and the costs associated with, each of the more common types of assistance granted by FSLIC and provides an evaluation of the savings to be achieved by exercising options available under the contracts. A second report will be made in November which will focus on the fairness issue and the competitive aspects of the agreements.

This first RTC report analyzes the agreements and determined what opportunities exist, within the contractual agreements, to reduce costs to the government. A copy of the report resulting from that analysis has been provided the Committee.

The report resulted from a review that was conducted by five private-sector groups under the direction of RTC staff. These groups included public accounting firms, law firms, investment bankers, consultants, and a public policy research group. Each group reviewed one or more of the 96 FSLIC assistance transactions completed between January 1, 1988, and the enactment of FIRREA.

Based on the reviews conducted, the RTC estimates that the total payments by the government on the assistance agreements will exceed $69 billion over the expected life of the contracts. This figure assumes that no changes are made in the terms of the present agreements and that no unilateral rights to reduce costs are exercised.

A significant portion of the costs, however, represents interest expense that could be reduced if the government expended funds now to prepay notes and reduce the amount of assets covered by yield maintenance agreements.

The report identified certain areas where an outlay of $18 to $20 billion in the 1991 fiscal year and the exercise of future note prepayment and the other options listed below could achieve savings in excess of $2 billion. These are:

--Prepaying approximately $11.3 billion in promissory notes in 1991 and at the earliest opportunity thereafter, the government could save as much as $1.2 billion in interest costs and tax subsidies.

--Payment of approximately $3.8 billion for the write-down to market value of covered assets in 1991 could save $535 million in yield maintenance costs and tax subsidies.

--Savings of approximately $520 million could be obtained if New West Federal Savings and Loan Association in Stockton, California fully exercises its prepayment options over the next several years on its $8 billion intercompany note with American Savings Bank, FA.

--While the government is effectively paying itself for $4.9 billion in notes held by government-controlled institutions, prepayment would provide the institutions with cash to pay off high-cost borrowings and save an estimated $40 million a year or a total of approximately $300 million over the life of the agreements.

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Attached is a chart that summarizes the potential cost reductions just described from unilateral exercise of the rights provided in the agreements.

There are other cost reduction opportunities that have not been quantified in the attached table, that could result in additional savings. These savings relate to selective asset purchases out of covered asset pools. It is estimated that selective asset buy-outs and other renegotiations relating to covered asset pools could result in additional savings of $1 to $2 billion.

Additional cost reductions also may be secured by a change in the current interpretation of the tax treatment of the deductibility of built-in losses. Appendix V to our report discusses the ability of acquirers to deduct built-in losses when a covered asset is repurchased by the FSLIC or FDIC for an amount equal to the taxpayer's basis and the acquirer is fully and directly compensated with FSLIC capital loss coverage. If this so called double dipping -- e.g. deducting a loss and receiving tax free compensation at the same time -- is disallowed, the savings to the government would be significant.

All of these findings, together with the remainder of the attached report, will be presented to the RTC Oversight Board this afternoon.

The Committee should be aware, however, that the Office of Thrift Supervision has determined that the employment of all prepayment options may threaten the viability of a number of the institutions. As a result, the report noted that the cost of the potential failures needs to be considered when assessing potential savings. Overall, a fair result for both the government and the contracting parties could be achieved by a renegotiation of these contracts reflecting the options possible under the contracts.

Thank you for the opportunity to present our report to you. I would be happy to answer any questions which you might have.

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Short T. 2

POTENTIAL COST REDUCTIONS FROM
UNILATERAL EXERCISE OF RIGHTS
IN NON-GOVERNMENT CONTROLLED INSTITUTIONS
($ BILLION)

Options	Cash Payments from FRF 1991	After 1991	Total	Potential Present Value Savings FRF Before Tax	Gov't After Tax
Prepayment of FSLIC notes	$ 8.4	$2.9	$11.3***	$ .5	$1.1 - 1.2
Prepayment of New West/American Intercompany Note	1.2*	6.0	7.2	.5	.5
Write-down of Covered Assets	3.7	.1	3.8	.3	.5
	$13.3**	$9.0	$22.3	$1.3	$2.1 - 2.2

* Approximately $780 Million will be paid in Calendar Year 1990.

** Does not include $4.9 Billion in FSLIC notes held by government controlled institutions that could be prepaid.

*** The $11.3 billion in FSLIC notes have been scored for Federal budget purposes in Fiscal Years 1988 and 1989.

The CHAIRMAN. Thank you, Chairman Seidman.

You have a lot of things to do.

You have a busy job, probably as tough a job in the Government as there is, with perhaps the exception of the Presidency, and we all appreciate that.

Having said everything that is in your statement, I would like to ask you just a very straight-forward, bottom-line question. That is: What do you think we ought to do here?

In other words, where do you think the area is of the greatest promise? Do you see something here, an action that you would recommend taking, and a savings to be had from that?

Mr. SEIDMAN. I think that the Government ought to save every penny they can.

In order to do that, we will have to be given the ability to obtain the buy-out funds that I referred to.

I think we ought to have sufficient buy-out funds to exercise every option under the contract that will save the taxpayers money.

If we are given those buy-out funds, we will approach the people that contracted with the Government, and it would be my recommendation that we would say, well, we can buy you out.

In the alternative, if you would like to renegotiate the contracts in order to provide us with the savings which we can achieve through the buy out, or most of the savings that we can achieve through the buy out, then it might be wiser for the Government simply to renegotiate the contract, in which case none of the buy-out funds would actually have to be expended and we could have the particular pleasure of returning those to the Treasury.

The CHAIRMAN. What is your best estimate? I realize that this might vary, but you are a very sophisticated financial professional.

What do you think is out there for us to save if we give you the resources to go out and go through this renegotiation process and buy-out process and so forth? What are we talking about here? $2, $3 and $4 billion?

Mr. SEIDMAN. I think that the savings ought to be in the area of $2 to $4 billion a minimum.

There are the additional savings in the tax area which will depend, importantly, on the Treasury, the IRS and their interpretations.

Then there is also the potential savings, if any, as a result of the November transactions.

I would point out to you that some of the largest transactions do not have these options in the contract. So there is no way that we can exercise an option and make the savings in those areas.

The CHAIRMAN. Unless the second report were to show that those deals were defective in terms of favoritism or something else.

Then I assume you can crack them open? Is that right?

Mr. SEIDMAN. Unless the second report gave us some legal basis for attacking the contracts.

At this point, we do not have evidence of that, but we are continuing our investigation.

Then the other part of it is the tax benefits. That is complicated by what assurances the Government may have given purchasers at

the time of what the IRS interprets the best, most accurate view of the tax law is, and a number of other things.

The CHAIRMAN. Just to finish this, in order to go out and try to save the $2 to $4 billion, how much do you need from us to work with in order to get get that savings—just, again, in round numbers.

Mr. SEIDMAN. $18 to $20 billion.

The CHAIRMAN. Taking the $18 to $20 billion, you also need money because you are running out of cash to go out and liquidate failed thrifts, so you need money for that purpose which is a separate and different purpose. And you also need working capital.

Just so we can add it all up, your latest estimate of the additional money you need to go out and close failed thrifts for your working capital is how much?

Mr. SEIDMAN. Together? Approximately $100 billion in the next fiscal year.

The CHAIRMAN. So you need $100 billion in the coming fiscal year, and then this $18 to $20 billion would be in addition to that? Is that correct?

Mr. SEIDMAN. That is correct.

The CHAIRMAN. What are you down to now? What do you have left in the cash box in terms of doing your job?

Mr. SEIDMAN. Let me see if I can get a daily report.

[Pause.]

About $13 billion, which we will exhaust in the next quarter.

We will be up against both the loss limitations and the debt cap. We have two limitations, Mr. Chairman.

One is to fill the hole for the losses. The other is to provide working capital and purchase the assets until we can sell them.

The CHAIRMAN. When you say $13 billion you are going to exhaust in the next quarter, is this the quarter we are in, or the first quarter of next year?

Mr. SEIDMAN. The first quarter of next year.

The CHAIRMAN. You will be out of money sometime in the first quarter of next year.

Mr. SEIDMAN. Right. The first quarter of the next fiscal year.

The CHAIRMAN. So the $110 billion is a figure that you need for the coming say fiscal year? Is that right?

Mr. SEIDMAN. That is correct.

The CHAIRMAN. So the $18 and $20 billion would be on top of that?

Mr. SEIDMAN. Yes.

The CHAIRMAN. My time is up.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

Chairman Seidman, let me leave this subject for a minute and go to another one, because obviously there is no member of this committee that does not agree with you that we ought to take every action we can in the 1988 deals to save as much money as possible, but there is another area which I happen to believe we can save a lot of money in.

That is, in the area of my Lender Liability bill.

I am frankly appalled at the environmental groups and the intimidation that they have exercised on many of my colleagues in

both the House and the Senate who come up to me and say, we agree with you, Jake, we ought to pass that, it is important, but I cannot afford to be perceived as being anti-environment.

Where I am appalled is that their testimony is so dishonest, to put it very bluntly.

This bill has nothing to do with spilling more chemicals of any kind. It does not harm the environment in any way whatsoever.

It does not change any conditions. It does not change the Superfund.

It says simply that innocent lenders are not going to be held liable. That is why we produced the Superfund bill.

That is why we have over $8 billion sitting in that Superfund bill, to take care of those problems. So that is not the issue.

Certainly it is not with me. I would not be proposing a bill that added environmental problems to that situation. But I continue to learn more about it, even since I introduced my bill. This is an enormous potential cost to financial institutions, threatening the viability of some of them—I heard of another case yesterday where one loan that they made, and it is a relatively small loan, but if they are held liable for the environmental cleanup of a piece of property, it would cause the entire institution to fail and RTC would own that institution.

Then what happens is, FDIC is going to be responsible for that cleanup.

So I am frankly frightened by what is going on out there in additional costs that nobody is talking about. I think there are billions of dollars involved there.

What I want to know is, am I overstating the case? Or is this important legislation that ought to be passed before Congress adjourns this year to save potentially more money than we are talking about saving in restructuring the 1988 deals?

Mr. SEIDMAN. Senator, I agree. This is vital legislation for the proper operation of the RTC. I agree that it is basically not an environmental issue.

It is an issue of whether either lenders or borrowers are going to have to pay for liability which they had nothing to do with creating and did not know about.

Frankly, it is going to be very costly for the RTC and for the FDIC if we do not address this problem.

So I would urge all of the Members of the Congress to take a serious look at this, because we think that bill is very important.

It also has a number of other important provisions in it which will be helpful and will save money for the FDIC, including the Golden Parachute provisions, the Priority of Claims' provisions, the Bankruptcy provisions, as Senator Dole has suggested.

We strongly urge passage of that legislation before the end of the year, if it can be done.

Senator GARN. I am frankly very frustrated because the issue is being portrayed, as I have said, as something that it simply is not.

You are having to come before us and ask for over $100 billion. Everybody on this panel, and everybody I talk to wants to know how to minimize this problem.

You have a group of environmentalists portraying this as something that it is not, and those extra billions of dollars will be on

those environmental groups' responsibility if this bill is not passed, because that is the only reason it is being stopped.

I do not know how to put it more clearly that it does not change anything except who pays. That is what the Superfund is for.

If I have to vote for more Superfund funds to take care of the problem, I am willing to do that.

I am on that Subcommittee of Appropriations. But it is not fair to compound the S&L crisis, nor to put more banks on the troubled list, or to put more savings and loans in your ownership.

That just makes no sense at all.

So I fully intend, and I want everybody to be aware, that I fully intend to push this as hard as I can and to separate it from an environmental issue.

That is why I asked you the question apart from the 1988 deals.

We are talking about potentially much larger savings here than we are in restructuring the 1988 deals, and we ought to be doing both.

Let me just ask one more question, Mr. Chairman. My time is about up.

You testified just a few minutes ago to the Chairman that we are running short of money.

If we do not provide the resources that you need, are we not running the risk of putting ourselves in exactly the same cash-poor position we were in in 1988 that produced some of those overly costly 1988 deals which, if there had been sufficient money and authority provided by Congress, the FSLIC would not have been pushed into?

Mr. SEIDMAN. Yes. I think we will be put in that same position and we will have the same choices they did—which is, either to do no deals, or to do costly deals.

Senator GARN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Before calling on Senator Shelby, Senator Kassebaum has come in. Do you have any opening comments?

Senator KASSEBAUM. No.

The CHAIRMAN. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman Seidman, you have got a reputation here on this committee, and on the Hill, and probably throughout the country of candor, which we like.

On the cost here, we are running short of money. You are running short of money.

But the taxpayers and the people of America are running short of patience, and we are hearing from it every day as elected officials and as members of the Banking Committee here.

I remember several years ago—and it was not you; I want to exclude you from this—that they came before this committee and said, we need $5 to $10 billion at the most to bail out the savings and loans.

Well, we found out that was not true. That was a long way off the mark.

Then, was it last year, a little over a year ago, $50 billion was going to do the job. A lot of people did not believe it.

I do not recall you ever saying that, that that would do it. Now you need $100 billion more?

Are we not basically in a bottomless pit here that we really do not know about? We have had the General Accounting Office over here, we have had you over here, and we have had some consultants, some of them pretty much on the line.

I know there was one, Mr. Healy, that was ridiculed before this very committee several years ago when he said that the savings and loan costs would probably exceed $80 to $100 billion.

He was low-balling it. But everybody said, oh, no, no.

Where are we today? We know what the problems are out there.

You know, the big auction the other day failed for various reasons. It did not work. It was for $300 billion. We have got to have that money. We know you are a dedicated man.

What can we tell the American people? What can we tell our constituents about this? We come up with $50 to $100 billion, but I do not see any end in sight.

Mr. SEIDMAN. It is a difficult matter, obviously, Senator, and I understand the frustrations. We have a few of those inquiries ourselves from irate people.

The difficulty with coming up with an exact number is that of course you are trying to predict the future.

I think we are moving along in getting the job done.

The further along we get, the more actively we can predict what the cost is going to be.

If you just take the RTC alone, the Secretary of the Treasury testified it was somewhere between $90 and $130 billion. We are further along now, and we believe those numbers are reasonable, although it is clear to us that it will be much closer to the higher number than it is to the lower number.

But I can say that if real estate markets get worse, if we have a deep recession, more institutions will fail, real estate prices will be weaker, and the costs could exceed that.

But I would say that right now, given today's conditions, we are somewhat more confident of the numbers that we are giving you than we were in the past.

Senator SHELBY. Has this administration basically painted a more rosy scenario than a realistic one? A more hopeful one?

Mr. SEIDMAN. With regard to estimating the costs to the RTC, when the Secretary came out with his $90 to $130 billion, I think that was the end of "rosy scenarios." So I think that those are estimates that people can disagree with, and I think some people say, well, it will be $150 instead of $130 billion.

And if you make certain assumptions you can certainly get to that.

I think those estimates are reasonable. I say this with some more confidence because we have now had our people in most of the S&L's, so we think we have a better feel for it.

We believe that the losses in the area of $120 to $130 billion are as good an estimate as can be made now.

Senator SHELBY. Getting back on the subject at hand and the books before you at the table, is there evidence of fraud in these deals, these last-minute deals in 1988, that we are bringing before the committee today?

Mr. SEIDMAN. We have no evidence at this time, but we have not completed our investigation.

Senator SHELBY. You have got a Task Force looking into fraud there, have you not?

Mr. SEIDMAN. We are looking into every way that we could find that the Government could fairly claim that they had additional rights under these contracts, whether they are inside the contract or outside the contract.

Senator SHELBY. And in any of these deals where there is evidence of fraud or evidence of real close dealing where the taxpayers—that is, the American people—have really been taken, is it going to be your position that these deals are going to be reopened?

Mr. SEIDMAN. We will examine those deals and report to you and to the oversight committee what we find.

Then the decision will have to be made on how that is going to be handled.

Senator SHELBY. My time is up. Thank you.

The CHAIRMAN. Thank you, Senator Shelby.

Senator Bond.

Senator BOND. Thank you, Mr. Chairman.

I share some of the frustrations of my colleague from Alabama as expressed about the size of the cleanup. I believe I was one of the few who argued that we ought to put $15 billion in a couple of years ago, and we had to compromise even to come up with $10 billion.

So there have been a lot of us who have been surprised by the scope of it.

I also, I think for clarification, if I recall when the Secretary of the Treasury came before us and gave us the $90 to $130 billion figure for the Resolution Trust Corporation, that that assumed no significant economic downturn.

Was that not an explicit caveat? That if the economy goes into the tank, we could be looking at even higher costs?

Mr. SEIDMAN. Yes.

Senator BOND. And obviously the front-page news that we have seen today in the papers is not particularly appealing. I believe that gets back to your statement, the one I referred to earlier, that you may need to look at supervised management rather than closing all of the troubled thrifts.

Do you at this point have any assessment as to whether a supervised management approach would require somewhat less than the $100 billion for next year? Do you have any feel for that yet?

Mr. SEIDMAN. I only know that supervised management essentially will not require funding because the institutions will not be closed down.

I want to make clear that what we are investigating is supervised management for solvent institutions that are not losing money and that have competent management and would go into the RTC because they do not meet capital standards.

Again, I want to repeat that no decision has been made in that regard.

Obviously the Oversight Board would have to consider that, the Treasury. So we are exploring this, and we will submit our findings to them for their decision.

Senator BOND. I think obviously we would be very much interested in knowing if the Oversight Board does come to that conclusion and would recommend somewhat less.

We definitely do not want to be in a position of limiting your ability to close thrifts that need to be closed, but it obviously would be of great interest to hear, if you do decide to go down that path, what impact that might have on the need for funding.

Looking at the possible silver lining in a very dark cloud, do you see any potential for lessening losses in Texas as we see oil prices being driven up by the Middle East war and economic activity returning? Is that likely to have an appreciable effect on some of the assets in thrifts that have either been acquired or may be on your Resolution list?

Mr. SEIDMAN. I think longer term, higher oil prices are certainly going to help the Southwest and particularly Texas where we have most of our properties.

One would expect that that would help us dispose of property.

Senator BOND. I was interested in your conversation, in your discussion with Senator Garn about the lender liability.

Do you have any estimate about the cost of the current legal liability for lenders on the RTC?

What are we talking about here? Are you seeing significant costs or an inability to sell properties because of the current liability for hazardous wastes?

Mr. SEIDMAN. Yes, we are. We have over 100 properties involved right now between the FDIC and the RTC, and more coming up every day.

Of course there is the additional cost that the buyers do not know whether there is a liability there that nobody has found, and that is the real detriment to their making a deal with us.

So there is an unknown cost in terms of the effect on the marketplace. But we already have more than 100 pieces of property that this affects.

Senator BOND. Do you have any assessment of the magnitude of those properties, the 100 properties, that have problems? Do you have a quantifiable amount?

Mr. SEIDMAN. I cannot give you that right now. Just the amounts we know about are over $100 billion, but I cannot give you the total amount.

Senator BOND. But it is your judgment that beyond that there is a decided chilling effect on all property sales that arise because of the current liability situation?

Mr. SEIDMAN. That is right.

Property sales, lending money, when you put an unknown of that magnitude into the economic system, the private free-enterprise system like we have, it is a real chill on the whole system.

Senator BOND. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Bond.

Senator Wirth.

Senator WIRTH. Thank you very much, Mr. Chairman.

I want to briefly follow up, if I might, on the funding issue, Mr. Seidman.

Chairman Riegle and Senator Byrd and Senator Sasser, Chairman of the Appropriations Committee and the Budget Committee,

wrote to Nick Brady on July 16 asking for clarification about the funding needs of the Resolution Trust Corporation.

On July 31, the Chairman received a response back from Secretary Brady who said, "We have not received from the RTC an operating plan for the first quarter of fiscal year 1991."

He goes on to say, "In the absence of action by Congress, we would be faced with a choice between using the $18.8 billion to raise working capital, and shutting down the resolution activity of the RTC."

At the end of his letter, the Secretary says:

"Whatever alternative is chosen, it will be necessary for the Congress to take some action before adjourning for the year."

But I do not know of any action that has been requested of us by the administration.

The letter asked the administration for what ought to be done and received back a list of options, rather than any specific request.

Now this is from an administration who has been highly critical of the Congress for not providing the resources that were necessary in the Jim Wright case some time ago. Now we are saying:

What do you want?

Let us know.

We are about to go out. As far as I can determine—and I would like to include these letters in the record--we have received no request from the administration about what has to be done.

[The following material is submitted for the record:]

United States Senate

WASHINGTON, DC 20510

July 16, 1990

The Honorable Nicholas F. Brady
Chairman of the Oversight Board
Resolution Trust Corporation
Room 3419
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Chairman:

We are writing to seek clarification on your view of the near term funding needs of the Resolution Trust Corporation (RTC). In your testimony last May before the Senate Committee on Banking, Housing and Urban Affairs, you indicated that substantial additional funds will be necessary for the RTC to fulfill its tasks. Indeed, you have also indicated that it is very possible that the RTC could run out of funds this year.

It now appears, at least in terms of numbers of institutions resolved, that the RTC has exceeded its spending and resolution goals for the third quarter of fiscal year 1990. Moreover, last week the RTC announced plans to sell 14 large institutions with approximately $40 billion in assets in the near future. This heightened activity will undoubtedly severely strain RTC's already limited resources.

Because RTC's funding needs could have significant ramifications for the pending budget negotiations, as well as potential legislation and the Congressional calendar this year, we ask that you tell us as specifically as possible when RTC's resources will be exhausted and when you anticipate it will be necessary for Congress to provide additional funding.

If you do not believe that the RTC will have sufficient funding to complete this fiscal year, please tell us how much more money will be required. In any event, please tell us what RTC's funding requirements will be for fiscal year 1991.

Thank you for your consideration of these matters. We look forward to your prompt response and to working with you on this important matter.

Sincerely,

Jim Sasser

Robert C. Byrd

Donald W. Riegle, Jr.

THE SECRETARY OF THE TREASURY
WASHINGTON

July 31, 1990

The Honorable Donald W. Riegle, Jr.
United States Senate
Washington, D.C. 20510

Dear Don:

This letter is to respond to the inquiry which you have sent, along with Senators Sasser and Byrd, about funding for the Resolution Trust Corporation (RTC). Specifically, you have asked for an assessment of RTC's near term funding needs.

In the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), Congress provided the RTC with $50 billion to fulfill the government's pledge to insured depositors in failed thrifts. It allows the RTC to enter into obligations in excess of that amount, but limits the amount of loss which the RTC may incur to $50 billion.

In testimony before the Banking Committee on May 23, we stated that the RTC could, with an aggressive schedule of case resolutions, run out of loss funds by the end of this calendar year or early next. That projection has not changed. It appears unlikely that the RTC will have any substantial amount of loss funds to carry it beyond December 1990.

As of July 2, 1990, the RTC had resolved 207 failed thrift institutions with estimated losses of $24.6 billion. The RTC plans to resolve another 77 cases during the fourth quarter of fiscal year 1990, for which losses are estimated at $11.6 billion. Adding in administrative expenses not reimbursed by receiverships and the initial use of the accelerated resolution program brings total estimated losses incurred by the RTC to $37.3 billion by the end of the fiscal year.

We have not received from the RTC an operating plan for the first quarter of fiscal 1991. It is reasonable to assume, however, that most or all of the remaining $12.7 billion in loss funds could be expended during that period. Near the end of December 1990, case resolutions would cease unless Congress provided additional authority.

There is a second funding issue which directly affects the RTC's ability to operate. As you know, the RTC borrows from the Federal Financing Bank (FFB) for working capital and enters into other obligations in the course of resolving failed institutions. FIRREA contains a limit on the maximum amount of obligations which the RTC can have outstanding.

When the Oversight Board appeared before the Banking Committee in May, we stated that the RTC is likely to run up against FIRREA's obligation limitation as soon as or sooner than it uses up the $50 billion. It now appears that the cap will begin to bind by the start of the first quarter of fiscal year 1991. This will restrict the RTC's ability to borrow for working capital, which in turn would place severe limitations on its ability to proceed with resolutions.

A literal reading of the note cap would allow the RTC to borrow for working capital at least well into fiscal year 1991. Such a reading would include only REFCORP contributions (not Treasury contributions) in the calculation, which would give the RTC an additional $18.8 billion to collateralize working capital borrowings.

In the absence of action by Congress, we would be faced with a choice between using the $18.8 billion to raise working capital and shutting down the resolution activity of the RTC. We would not, however, approve any RTC funding plan which relies on this additional authority without first advising Congress.

Finally, you have asked about RTC funding requirements for fiscal year 1991. As we have testified, a representative range of the resources the RTC may need in fiscal year 1991 to cover losses should be from slightly over $30 billion to slightly over $50 billion. We estimate that working capital needs should be from $20 to $40 billion, although if asset sales are significantly lower than projected, working capital needs could be higher.

It is clear that Congress must act to provide additional resources to the RTC before the end of the year to keep the cleanup process going. While, as we said in our May 23 testimony, funds will have to come from the Treasury, there are a number of alternatives from which to choose.

One alternative would be to consider appropriating an amount sufficient to keep resolutions going into the beginning of calendar year 1991. At that point, funding legislation could be considered against the backdrop of the study of federal deposit insurance mandated by FIRREA and which the Treasury has indicated it expects to submit at the end of the year.

We estimate that an appropriation of $5 billion, combined with a literal reading of the obligation limitation, should allow the RTC to continue resolution activity through January 1991. An appropriation of about $10 billion (and the same reading of the note cap) should fund resolutions through February.

A second alternative would be to provide the RTC with permanent, indefinite authority to complete the job of resolving failed thrifts. The government has already incurred the obligation to insure deposits and has no choice but to provide funding. Such authority would permit the process to continue uninterrupted by potential funding delays.

A third alternative would be to provide funding in an amount likely to cover estimated needs for fiscal year 1991 or another intermediate period.

Whatever alternative is chosen, it will be necessary for the Congress to take some action before adjourning for the year. Moreover, it will be necessary to address the limitations imposed by the note cap. The RTC cannot be allowed to run out of money, causing the process to grind to a halt.

The Treasury and the Oversight Board stand ready to work with the Congress to develop legislation based on any of the proposals outlined above or to explore additional options.

Thank you for the opportunity to respond to these questions about the RTC's funding needs.

Sincerely,

Nicholas F. Brady

Senator WIRTH. The first question is, Secretary Brady says:

"We have not received from the RTC an operating plan for the first quarter of fiscal 1991."

Do they now have from you an operating plan and know what resources you need?

Mr. SEIDMAN. Yes.

Senator WIRTH. They do have that?

Mr. SEIDMAN. Yes.

Senator WIRTH. When did they receive that?

Mr. SEIDMAN. About 2 weeks ago.

Senator WIRTH. Mr. Chairman, do you know if we received this information?

The operating plan that Secretary Brady refers to in his letter to you of July 31 has now been received by the Treasury Department. Has that been transmitted to us?

The CHAIRMAN. Not as yet.

Senator WIRTH. How long do we have to wait? We are only going to be here until the middle of October.

How large is your request? Do you remember, offhand?

Mr. SEIDMAN. The request that we made is about $100 billion.

Senator WIRTH. So you have made a request to the Treasury for $100 billion, and they have not transmitted that to us yet. Is that correct?

You have not received that?

The CHAIRMAN. Not yet.

Senator WIRTH. I do not know—we have to have that pretty quickly, do we not, in order to act on that so that you do not have to, as he says in his letter shut down? Is that correct?

Mr. SEIDMAN. We would like to have it, yes, sir.

Or, if you have complied with all of your requirements to get the request to us, you have to go through the Treasury Department to get that to us.

Is that correct?

Mr. SEIDMAN. That's correct.

Senator WIRTH. I'm astonished, Mr. Chairman, that we have not received a request for $100 billion from the Treasury.

Now, I don't know what is going on here, but I can just make a guess that, one, they don't want to send that up here at the time of the budget negotiations. That's $100 billion more in a package that's already difficult.

I understand that. And, we've got to be honest about it.

Or, second, don't send it up. Shut down some activities at the RTC and blame the Congress because the Congress didn't act. But, the administration never sent us up a request to act.

So I think, just from what Mr. Seidman is saying, that we ought to right away, again, Mr. Chairman, write to Secretary Brady and ask him what it is that he requests us to do, so that Mr. Seidman's operation doesn't, in his words, get shut down.

It seems to me that's a reasonable request for us to be making now of the Secretary of the Treasury. If there's $100 billion at stake here, we ought to know and have that request so that we don't leave and they don't say, Hey, you guys didn't act. And they didn't ask us to act.

The CHAIRMAN. We should have a formal request, there's no two ways about it. It sounds, if I understand your testimony, you conveyed your request to the Treasury Department, so they have it, and are presumably in a position now to tell us what they feel we need.

But, until that letter comes, I think we've heard it directly from you how much you need. You're going to run out of cash in the first quarter; you need $110 billion, plus this extra amount if you're going to go back and read through these deals and save some money.

And you haven't equivocated on the number. You've been very direct about the number.

Senator WIRTH. Mr. Chairman, we don't know. How does the administration want us to operate. Do they want us just to give them a small amount of money to tide them through until the new cycle in 1991 and, therefore, avoid the Budget Summit?

Do they want us to just give them a blank check and, therefore, absolve us of any future accountability, an issue that we have to debate? And do we give them a blank check and say: Whatever you need in the future, you've got?

Or, should there be a tighter rein on this from the Congress and from the American public?

Or, third, do we give them the whole lump sum that they request?

I'm not sure. We ought to have a request from the Treasury as to what as a matter of policy do they want—this is $100 billion. The RTC is going to get shut down. This enormously important effort will be shut down if they don't have the authority to operate.

Now, we don't want to take the wrap for them being shut down because we didn't act. We want to make sure they make a request of us and tell us very specifically, not a list of options, but what it is that the administration wants.

The CHAIRMAN. You were going to make a response to that, Chairman Seidman?

Mr. SEIDMAN. As I remembered, when I testified with the Treasury before the House, they gave the amounts they thought were necessary, but they said:

Here are three ways that you might do it.

And that's where it was left.

Senator WIRTH. I think that's correct. They had that same kind of response in their letter to Chairman Riegle. But, I don't think that's appropriate, Mr. Chairman. They've got to say to us, you know, do they want the whole thing? What do they want? What does the administration want?

They have the responsibility for governing. They are the administration; they were elected to do this job. And they can't waffle out of this.

"Waffle" may be too strong a word, but I think here we are in a situation at a very difficult time. And I would hope that this committee might send a letter, a strong letter, saying:

We would like to have from you a request for what you want.

And have this very rapidly because we have to move.

The CHAIRMAN. We had invited Secretary Brady to appear before the committee still this month, before we adjourn. And we had

hoped that would be one of the items that he would present if we had not heard from him before that.

And he's indicated that his present intention is not to come himself, but to send Mr. Glauber. But, that aside, we do need a formal recommendation. This is an enormously important issue. It's a tremendous amount of money. We're not going to sign any blank checks around here.

I would hope they wouldn't ask for that. And if they are, that's not something I would support. But, whatever they think they need, this whole amount or some part of it through some time period, I think needs to be made explicit.

So, let's do two things. We're all part of the same Government and you're pressing up the chain to try to get the money that you have told us now today you must have. I think we'll press the other way, to try to get a clear, precise request out of the administration.

Then, we'll endeavor to meet it as best we can. We'll have to make our own judgment and the committee will have to decide what's in order, and the Senate as a whole.

But, we will move on a timely basis. But, you're quite right, Senator Wirth, until we have some clear request out of the administration, it's very difficult to know what it is they feel they need and to be able to respond.

Senator WIRTH. I realize how difficult the $100 billion is to deal with in this Budget Summit at this time. But, let's be honest about it. The fact is this is a reality that we have to deal with.

Mr. Chairman, I have another set of questions related to a potential conflict of interest and some problems that may exist with one of the contractors who is involved in this study.

But, if we're going to have a second run, I hope that's a possibility. My time has more than expired, and thank you very much.

Thank you, Mr. Seidman.

The CHAIRMAN. We'll come back around for a second round.

Senator Kassebaum.

Senator KASSEBAUM. Thank you.

Chairman Seidman, in talking about the desire to refinance some of the 1988 deals, it seems to me we're all agreed that we just don't have the money or credit to come up with some $20 billion that would be necessary to refinance the deals at this point, even though the obvious savings are going to be there.

I don't know where it's going to come from at this juncture in our budget negotiations. So it seems to me that this option is out at this point.

I would like to ask about another one that certainly doesn't have the up front money requirement and, obviously, probably doesn't have the significant savings either. But, you touch on it in your report.

That's the additional cost reductions also may be secured by a change in the current interpretation of the tax treatment of the deductibility of built-in losses.

I would like for you to expand on that a little because it seems to me this is something that clearly works to some great benefit as deals were rapidly struck at the end of 1988 in order to take advantage of the deductibility for tax purposes.

How much savings do you think might come from changes to that?

Mr. SEIDMAN. Senator, that's very difficult to estimate because the tax effects have to be worked back into the individual taxpayer's position. But, it certainly is in the billions if the interpretations were such that the so-called double-dipping was eliminated.

On the other hand, there's a real question about whether the Government is in a position to effect that kind of a tax ruling based on the past negotiations that they had.

We are looking at that and giving the Treasury Department all the information we have in that regard. And I think that will then become a Treasury/IRS matter.

Senator KASSEBAUM. I'm sure there would be some real concerns if we could go back and legally undo that. But, on the other hand, those tax breaks are no longer available and the benefits have risen dramatically to those who took them because of some unexpected windfalls.

I would just hope that, from the standpoint that I see us not being able to get the $20 to, $22 billion that might be necessary to help refinance, that we take a look at this first, because I think there are some real questions in that.

And it seems to me that's a good place to start.

Mr. SEIDMAN. I think it's something that needs to be carefully reviewed by the Treasury and the tax authorities so, they can determine what position they want to take.

Senator KASSEBAUM. I'd also just like to suggest—I think it was Senator Garn, and I support his lender liability legislation, but he said:

Won't this mean that costly deals may be further advanced just because we're not taking action now?

Or, something to that effect? We may be opening up just further losses and further costly undertakings that we will have to absorb.

I would just like to suggest that maybe we should just let them fail.

Mr. SEIDMAN. The question is whether the failure of a transaction will simply cost us more than it would if we could provide this lender liability protection.

Senator KASSEBAUM. The lender liability protection is fine. I don't mean to equate that. But, if we're going to have further losses and further failures of institutions, perhaps rather than going in with all of the costly operations, particularly as we're holding the assets, that we're not able to move, we ought to just let it fail and let the directors of those savings and loans be responsible for their failed product.

Mr. SEIDMAN. Our problem, of course, is that they have insured deposits. When we let them fail, that's when the Government has to come up with the money.

Senator KASSEBAUM. We have to take care of the insured deposits, but we split off a lot of the deposit accounts, which are the more promising part of some of these assets, and left the real dogs, which we pick up.

And I just feel that either the people purchasing these—and we've always made the argument, well, they wouldn't purchase it if they had to take some of the questionable assets—but they've also

gotten real benefits, and I think they should take the questionable assets along with the promising assets.

Mr. SEIDMAN. The problem is we're dealing with a free market. And you can lead a horse to water, but you can't make him drink. If they don't want to buy them, we can't force them to take them. In other words, we have no power to make buyers take all the assets.

Senator KASSEBAUM. I guess I just don't understand. When we pay off, as we have to, the depositor and the investor, those who hold deposits there, I don't see that we have any continued responsibility beyond that.

Mr. SEIDMAN. We don't. But, what we have to do is take the assets and try to reduce our loss by selling them.

Senator KASSEBAUM. But, it hasn't worked very well.

Mr. SEIDMAN. Well, it's better than the alternative, which is to just take the loss and not have anything to offset it.

Senator KASSEBAUM. I guess, you know, we raised the deposit insurance and provided some cushions there that haven't really caused any major disruption.

Perhaps we need to let a few failures occur for people to realize the crisis it is. And I personally think what's outraging the public is those who have been heads of institutions that have not acted responsibly have been able to take Chapter 11, shelter the million dollar loans, shelter their assets, when we hold the dregs.

That's why the public is just so outraged.

Mr. SEIDMAN. I totally agree. And, Senator Garn's bill deals with that as well. That's another reason to pass it.

Senator KASSEBAUM. Exactly.

The CHAIRMAN. I might just say, before yielding to Senator Graham, that in the legislation that we've passed this year and which is pending, as well as some provisions of FIRREA, we've put into the law a way to reach back and grab people that behaved improperly. Turn them upside/down and shake the money out of their pockets, and get it back.

But, with respect to the assets, as the Chairman has just said, when an institution is insolvent and you go in and you shut it down because it has no value left and you pay off those insured depositors, the only thing that's left are the assets on the book of the institution.

And they can be a range of things. They can be home mortgages. They can be commercial buildings, or whatever it happens to be. That's the only thing that's left.

And you take those things in the name of the taxpayer and they go into the RTC and you try over a period of time to sell those and get something for them, and then the Government or the taxpayer gets the money back for the value of those assets.

But, I suppose the better answer is, if you can find that problem institution before it's broke, you go in and you shut it down before the value of the company is totally exhausted and then, of course, you don't have this claim on the insurance fund. And you don't have to take the assets and later try to liquidate them.

But, I gather you're getting—I don't want to trespass any further on Senator Graham's time, so I'll just make this as a statement.

My understanding is that you're getting more and more institutions that are becoming insolvent. So, on the one hand, Mr. Kelly said the other day:

Well, you're getting some assets out the door. You've got more assets coming in. So, right now, you've got something on the order of $160 billion worth of assets in your inventory of all manner, shape and form; whereas, roughly, at the end of last year, I think you only had $100 billion.

So, even as you get rid of assets, you've got new assets coming in in a greater amount than those you're able to dispose of.

Is that correct?

Mr. SEIDMAN. That's correct. We've already sold around $80 to 90 billion of assets, but they're coming in faster than we're selling them.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

Mr. Seidman, I would like to go to the issue of what have we learned from the 1988 experience that would be applicable to the circumstances in 1990?

In reading the summary of the report, it states that, in reviewing this discussion, it is important to have an understanding of two basic factors that drove the structure and timing of the FSLIC agreements.

First, the FSLIC was without the financial resources to effectively absorb the losses and asset-carrying needs. It was facing—in short, it could not pursue a liquidation strategy where appropriate.

Would you comment as to the current state of FDIC as it relates to commercial banks, to the adequacy of its capacity to pursue a liquidation strategy where appropriate?

Mr. SEIDMAN. The FDIC Fund has about $12 to 13 billion of resources at the present time. And given our schedule of liquidations that we now know about, we will be able to handle those in the most cost-effective way, which will include liquidation, if required.

Senator GRAHAM. You do not anticipate that the FDIC would be constrained in terms of taking the most fiscally-appropriate action because of limitations in its working capital funds?

Mr. SEIDMAN. I think, at this time, we have the appropriate resources under current conditions. I can't guarantee you it will be that way in the future. That will depend upon how many failures we have and what economic conditions we have to deal with.

Senator GRAHAM. Earlier this summer, on a Sunday news program, you made some statements about the FDIC funds in the context of future economic conditions.

That's been about 60 days since you made those initial comments.

Given what has transpired in the intervening 60 days, what is your assessment of the FDIC fund in the context of the economy in which it's likely to be operating?

Mr. SEIDMAN. I think it's under greater stress now than it was 60 days ago because we have continued to see eroding real estate markets, which are affecting bank conditions and affecting our ability to sell assets.

Clearly, things haven't improved in the last 60 days, primarily because of the problems in the Northeast. There is somewhat more stress than there was at that time.

Senator GRAHAM. Another factor that you have alluded to in the past is the need for early intervention and particularly relationships between the regulators and the FDIC Fund. Today's Washington Post carries an article based on testimony given yesterday by Richard Fogel, the Assistant Director of the General Accounting Office, in which it states:

> Fogel said yesterday that the Office of the Comptroller of the Currency, which oversees national banks, must do a better job of protecting the fund. He urged the OCC to use its regulatory powers more often to restrict troubled banks from excessive lending and payment of dividends, actions that drain badly needed cash.

Do you have any comments as to what you think should be done based on the lessons of 1988 in the way you have a close relationship between regulators and the insurance fund and give a higher priority to the protection of the insurance fund and regulatory activity?

Mr. SEIDMAN. I think our past experience in Texas, the Southwest and now the Northeast makes it clear that we need to further improve supervision. Supervision is one of the ways that we've got to hold down the cost to the fund.

I think it's clear to me, based on the experience that we've had in the last 5 years, that our supervision, while it has improved markedly from what it was 5 years ago, we now have almost doubled the number of supervisors we have in the last 5 years. The Comptroller has increased his supervision. But, I think much more has to be done.

Senator GRAHAM. Are you satisfied with the level quantitatively and qualitatively of supervision which is going to be available to the FDIC in the next fiscal year?

Mr. SEIDMAN. I wish we had more supervisors. We could use them. We have been increasing them as rapidly as we can train them. We've gone from roughly 1,400 to 1,500 to 3,000. We're trying to put on about 500 additional supervisors a year. I don't think that's as many as we could use.

Senator GRAHAM. Do you think your ability to recruit and train is greater? You say you could use more. Is it possible to have a more rapidly expanding pool?

Mr. SEIDMAN We are exploring that right now. I've asked our Division of Supervision. They've told me that's what they can do. I've told them I don't think that is what we need to do.

And they are exploring the possibility of another than larger step forward in that area. We've put in a new training program. We're building a new training center, which is key to putting the proper people on. We need to have the proper exemptions from Government hiring requirements so that we can hire rapidly, and from the best students.

We have been doing that. I think, last year, 75 percent of all our hires came from the top 10 percent of the class.

So we are moving in that area but I'm sad to say experience shows we could be moving more rapidly.

Senator GRAHAM. Mr. Chairman, my time is up. If there are any other lessons to be learned from 1988 that are applicable to the

1990 FDIC circumstances, I would appreciate it if you would share those with the committee, either today or by supplementing your comments in writing.

Mr. SEIDMAN. Yes, sir.

The CHAIRMAN. Very good. Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman.

Mr. Seidman, you've indicated a number of things we could do to save the taxpayers some dollars, which all of us are enthusiastic about, since we don't do a very good job in the Congress at doing that.

I would like you to focus on that time frame in the fall of 1988 when all of these deals we talked about were put together.

If you can, can you quantify what the savings would have been if FSLIC at that point had come to the Congress and said: Look, we need X-number of dollars, whatever it would have been, rather than going through all the incantations that we are now talking about.

Potentially, do you have any idea of what may have been saved?

Mr. SEIDMAN. That's difficult. We could have saved most of the money that I've just indicated, $3 to $4 billion. We certainly could have saved many of the tax benefit type expenditures. We could have saved money on contracts which we haven't referred to in here because the options were not put in those contracts.

So I don't know what the total number is. It would have to be substantially in excess of the $4 billion.

Senator BRYAN. I can appreciate that you can't speak with precision.

Can you give us a range, something you would be comfortable in terms of X to Y?

Mr. SEIDMAN. Let me ask the gentleman that did this procedure.

[Pause.]

I don't think we've really done that calculation. We would have to go through all the contracts where there were options and say if there were options, what could we save, and so forth.

All I can say is it would be substantially in excess of $4 billion.

Senator BRYAN. So, it seems to me, to pursue Senator Graham's line of questioning, one of the lessons that we ought to learn in the context of the 1990 situation that we face is that we ought to provide you as the regulator with the kind of assets that you need to, in effect, work through the process and save the most dollars we can for the American taxpayer.

You're recommending to us some $18 to 20 billion, if I can recall your testimony, and that the savings by, in effect, making certain prepayments that are available under the contracts that provide that option, could save us on the magnitude of $2 to 4 billion.

May I ask you does that savings factor in the costs that it would require or incur in borrowing the additional money to make that money available?

Mr. SEIDMAN. Yes, that offsets that cost.

Senator BRYAN. So, we're talking about $2 to 4 billion of net savings as well?

Mr. SEIDMAN. That's correct.

Senator BRYAN. With respect to those total dollars now, we are talking about—I think the Chairman indicated $110 billion. I

wasn't following the math. You indicated you needed $18 to 20 billion, and you indicated that you sent a request to the Treasury for $100 billion.

I take it, that $18 to 20 billion is not included in the $100 billion request?

Mr. SEIDMAN. That's correct.

Senator BRYAN. So we're talking something in the neighborhood then of $118 to 120 billion to provide the resources that you think that you're going to need prospectively, as well as the money that you're going to need to effect the savings of $2 to 4 billion on the prepayment option that you're suggesting to us?

Mr. SEIDMAN. Yes.

Senator BRYAN. In terms of generating that kind of money, obviously, we do not have it—to use the Chairman's terms—in the cash drawer. We have to borrow it.

Do you have a recommendation to us in terms of the method that we would use?

You will recall, of course, that some 18 months ago before this committee there was a raging debate as to whether we raise that money directly through the Treasury or we go through an off-budget financing mechanism, and a compromise was reached. Some of us favored the on budget and felt that there was a real savings in terms of lower interest rates and ultimately less cost.

In the context of your presentation for $100 billion plus the $18 billion, is there any recommendation that you would make to the Congress, Mr. Seidman, as to how we could, in effect, borrow that money to provide you the resources that you need?

Mr. SEIDMAN. Mr. Bryan, my responsibilities have been to spend it, not to raise it. So, I haven't given a lot of thought to that. But I think there's general agreement that Treasury borrowings would be the least costly method.

Senator BRYAN. I take it that that would be your preference if, indeed, that premise is correct?

Mr. SEIDMAN. I would like to see us effect the largest savings possible, yes.

Senator BRYAN. I know that my time is expiring. Thank you very much, Mr. Chairman.

The CHAIRMAN. Senator Kerry.

Senator KERRY. Thank you very much, Mr. Chairman.

Mr. Chairman, I would like to thank you, first of all, for this hearing, which I think is an important one; and, secondly, for drafting the legislation which authorizes the FDIC to raise the premiums, which I think is timely. And, hopefully, the administration will join us, I believe maybe next week, to do that.

And while some may think Congress is overreacting, I think, given the fact that one bank failure could conceivably wipe out that current fund, it's important for us to move.

Mr. Chairman, what concerns me and I think it concerns a lot of us here is the process by which this study has been carried out and some of the questions that may or may not have been asked in the course of it, and the concerns of the American people about undue profits that have been made in the course of this crisis.

President Bush came before the Congress the other day with respect to the Mid-East crisis and said very clearly:

"Let no one even contemplate profiteering from this crisis."

The S&L crisis is, frankly, an unparalleled crisis economically for this country. And I personally believe that people have been profiteering from it, that there has been a callous taking advantage of the crisis of the country in order to reap undue profits.

Nobody here is suggesting that you can save these banks without the normal marketplace working and without people having the ability to make a profit.

But, when you look at the fact that the Federal Home Loan Bank Board committed the Government of this country to $70 billion in expenditures, something that the President can't do alone, something that no Cabinet officer can do alone, and no one in Congress can do alone, we face a rather startling and extraordinary situation.

I am personally extremely concerned that the review of these deals and, in fact, the entire approach does not look adequately at all the circumstances that may or may not be contained in the question of profiteering.

It's my understanding, and let me assert also—I said this before and I say it again—no one's asserting that this was your responsibility or that these were your deals or anything like that, but I would like you to try to help us shed some light on this at this point in time.

And I want to ask you some questions with respect to it. It's my understanding that this study basically looks at the four corners of the contract and I am not advocating that those contracts ought to be arbitrarily wiped out. I don't think the Government can behave that way. And if we did, it would create great difficulties for future contracts.

But, if there is conflict of interest, if there were not arm's length transactions, if you do have some fraud or evidence of profiteering or misrepresentation of facts, it seems to me we have a legal and a moral responsibility to the taxpayers, who don't have the resources to step up to bat to make some of these kinds of deals and walk away with these profits, but who are shouldering the burden for them.

We've got a responsibility to guarantee that we are recouping where we could recoup.

Now, in that light, and in the light of the four corners transactions limitation—and I think it's a limitation because you can't get at all those other circumstances I've just talked about looking at the four corners of the deal.

So, let me ask specifically about one of these deals as it pertains to this four corners approach.

David Cook, former Deputy of the FDIC, became Executive Director of the RTC in August 1989; correct?

Mr. SEIDMAN. Yes.

Senator KERRY. What was his role in the RTC review of the Southwest Plan transactions?

Mr. SEIDMAN. He is in charge of the RTC. So, it was people in his organization.

Senator KERRY. So he was really responsible. He called the shots, in a sense?

Mr. SEIDMAN. He was the ultimate one. But he reports to me.

Senator KERRY. Are you aware that one week after FIRREA was signed by the President that Mr. Cook met with representatives of Thompson and Company, who, as you all know, represented the Phail transaction—were you aware that they met 1 week after the signing of FIRREA?

Mr. SEIDMAN. I know he met with them. I don't know exactly when.

Senator KERRY. I've been given a couple of memos which I would like to share with you, at least some excerpts from them, on the letterhead of Thompson and Company. And they're both initialed RLM for Robert Maiser, an associate of Mr. Thompson's.

I quote from it:

As you know from the new accounts, the Bush Plan for Recapitalization of the Savings and Loan Industry, i.e., FIRREA, has been initiated. President Bush signed the savings and loan bailout legislation on August 9th and the changeover in the regulatory agency structure began almost immediately, simultaneously. We are pleased that David Cook, former Deputy to William Seidman, has been appointed the Deputy Director of the Resolution Trust Corporation. We have worked with David for a number of years extending back to an assisted bank acquisition we participated in 2 years ago.

Do you know which bank he was referring to in that? Was that the Oklahoma—the United Oklahoma?

Mr. SEIDMAN. That was the bank that they purchased, yes.

Senator KERRY. And that's the bank which James Phail acquired; correct?

Mr. SEIDMAN. Correct.

Senator KERRY. So he had an association with James Phail at this time.

Mr. SEIDMAN. Who did?

Senator KERRY. Well, through the "we worked with David for a number of years."

Mr. SEIDMAN. I think that's sales baloney. I think he met with David once or twice in his career.

Senator KERRY. Do you know of any other associations Mr. Cook might have had with Thompson and Company?

Mr. SEIDMAN. I'm not aware of any, no.

Senator KERRY. Were you aware of that relationship when Mr. Cook was brought to the RTC?

Mr. SEIDMAN. Oh, sure. I asked Mr. Cook to meet with them when they came in to purchase the bank.

Senator KERRY. Let me just go a little further then, and I'll explain exactly why I asked this. I think you can understand why.

The memo then says:

Danny Wall, Chairman of the Federal Home Loan Bank Board and a dear friend, will continue as Chairman of the Office of Thrift Supervision.

Is there anything in the characterization "dear friend" that may have made it easier for Mr. Phail, who is a client of the Thompson Company, to acquire the Bluebonnet? I mean, is that relationship something——

Mr. SEIDMAN. I don't know that he was a dear friend. And I certainly have no idea whether or not that helped or hurt the transaction.

Senator KERRY. The key question is:

Is that something you're specifically looking into in the context of the 1988 deals?

Mr. SEIDMAN. Yes. As I testified, Senator, we are doing two investigations. One is within the bounds of the contract and those are the reports you see before you. The other is to examine the process by which the contracts were let and to see whether, based on that process, the Government has any grounds for additional claims under the contracts.

Senator KERRY. Will you also look at the issue and let me share with you from a second memo?

David . . ., i.e., David Cook . . . indicated that the FDIC staff had formulated procedures and a model for the review prior to enactment of the legislation.

The memo then says:

David assured us that the RTC's review would include discussions with Southwest Plan acquirers before any conclusions were reached. He also insisted that neither the RTC nor the FDIC had any intention of unraveling the Southwest Plan transactions.

So, is it also part of the inquiry—and the reason I ask this is that, until now, I've been led to believe that this was just looking at the four corners and that we weren't going to look at the facts that might lead up to it.

Will the inquiry involve discussion of why it is that a lobbyist participant in the Southwest Plan is working with someone with whom he'd previously worked and receiving assurances within weeks before the review has even taken place, that the Southwest Plan or any of those deals would not be unraveled?

Does that give any impression that the Sweetheart Deal that people have come to understand might, in fact, be a lot sweeter than people thought?

Mr. SEIDMAN. As I have said and as I testified and as we reported and as the statute says, we are conducting two investigations. One, within the limits of the contract, and another which we'll report on in November which looks at the circumstances under which the contracts were issued.

In that second study, which is not completed and which we would hope to have in November, we will address the issues of whether there were any circumstances around the signing of the contracts that gives the Government any legal rights to change the contract.

Senator KERRY. Did the FIRREA promise there would not be an unraveling of the deals?

Mr. SEIDMAN. Well, I don't quite know what "unraveling of the deals" meant. FIRREA has set forth, and I gave it in my testimony, specific areas that we were charged with reviewing.

Those were the two areas that I just mentioned. If I might, I don't know what David Cook said, but I don't take a lot of faith out of what someone said David Cook said when he has a point of view that he would like to get over with his boss.

Senator KERRY. But, on the other hand, if you're reading the memo between parties within—I see my time is up and I'll let Senator Wirth have the second round. But, if you're reading a memo which is to a client, making representations as to what he has ac-

complished on behalf of that client, particularly as to elements like that, at least it raises questions.

That's really what I'm saying because it seems to indicate sort of an inside track, and it seems to indicate that something is happening here that facilitated people at taxpayer expense making extraordinary amounts of money.

That's all I'm suggesting. And I think it's important for us to know that we're going to take a hard look at that. You've said we are and I rest assured that that will be the case.

Mr. SEIDMAN. Thank you.

The CHAIRMAN. I'm going to yield my time at this point to Senator Wirth.

Senator Wirth.

Senator WIRTH. Thank you, Mr. Chairman.

Mr. Seidman, I'd like to go to a potential appearance of conflict as to one of the firms who did the work on the report.

Under FIRREA, the RTC is required to examine and analyze all the 1988–89 FSLIC agreements to determine if there are opportunities consistent with the terms of the agreements to reduce the cost to the Government.

You contracted out, as I understand it, the examination of the 1988 deals to five private sector groups. These groups included accounting firms, law firms, investment bankers, consultants and a public policy research group.

Each group reviewed one or more of the ninety-six 1988 FSLIC deals. That is the background for what happened. The work was done by contractors. I want to ask you about a contractor by the name of McGladrey and Pullen, Certified Public Accountants and Consultants.

The reason I'm doing this is that it's absolutely imperative that we have a very clear understanding that there are no conflicts of interest, no problems related to any of these contractors.

Do you know the firm of McGladrey and Pullen? Have you dealt with them? Are you familiar with the firm?

Mr. SEIDMAN. I'm familiar with the firm, yes.

Senator WIRTH. Do you know what kind of a process was gone through, what kind of a background check the RTC did, conducted concerning the companies that submitted proposals to you to do the contracting under this study?

Mr. SEIDMAN. I know, in general, but perhaps the best thing to do would be to speak to Mr. Roelle, who was with me, who actually conducted it, to deal with that question.

Senator WIRTH. Could we do that?

The CHAIRMAN. Why don't you come up to the table, Mr. Roelle.

Mr. SEIDMAN. Mr. Roelle is in charge of resolutions in the Resolution Trust Corporation reports directly to David Cook and was in charge of this process.

Senator WIRTH. Mr. Roelle, could you tell us what kind of a check the RTC conducted, and if the RTC independently investigated the submissions to the RTC and the statements that were made about conflicts of interest?

Mr. ROELLE. Yes, sir. We asked them to give us a conflict of interest statement. We looked into it. We were aware, if you have reference to the McGladrey-Pullen lawsuit with an S&L that failed.

We understood that they had settled that lawsuit before they were hired. The amount was small. We had our Ethics and Conflicts Committee look at this. It was considered a de minimis situation.

So we were aware of that lawsuit and we did look at it and we did investigate it. And according to the standards that we were looking at with regard to this company and the overall project, the committee that looks at these conflicts did say that we could go forward with the transaction.

Senator WIRTH. What you are referring to is a complaint that was filed by the FSLIC in May 1985 charging that the firm at issue, McGladrey, Hendrickson and Pullen, had conducted a fraudulent audit at San Marino Savings and Loan in California.

That was the charge made by the FSLIC against McGladrey, Hendrickson and Pullen.

Is that correct?

Mr. ROELLE. I'm not familiar with the specific incident, but I assume that's correct.

Senator WIRTH. That complaint was settled out of court. The terms of the settlement were sealed and not made public. And at the time this was done, 1985, the San Marino loss was the largest thrift failure up to that point.

Now, when the conflict of interest statement was put together, presumably, McGladrey and Pullen would refer to that, wouldn't you think?

How did you find out that there was this FSLIC problem or charge in 1985?

Mr. ROELLE. I'll ask.

[Pause.]

I'm advised we went through the internal records to see if there were any current or active suits regarding any of the contractors.

Senator WIRTH. Would you presume that, in their letter saying that they have no conflict of interest of any kind that they would refer to that past history?

Mr. ROELLE. I don't know, sir. I have not seen——

Senator WIRTH. Their submittal was done on May 15, 1990. Mr. Louis Wright. I'd like to submit that for the record.

[The following is submitted for the record:]

✓ McGLADREY & PULLEN

Certified Public Accountants and Consultants

(1)

May 15, 1990

Mr. Louis Wright
Resolution Trust Corporation
801 17th Street, N.W.
4th Floor
Washington, D.C. 20429

Dear Mr. Wright:

The purpose of this letter is to provide certifications relating to organizational and personal conflicts of interest in connection with the pending contract award to McGladrey & Pullen and its sub-contractors of the Review of the Federal Savings & Loan Insurance Corporation Assistance Agreements (RTC-P-2122). Subcontractors covered under this certification include:

Thacher Proffitt & Wood
Danielson Associates, Inc.
Mabon Nugent & Co.

1606.6 ORGANIZATIONAL CONFLICTS OF INTEREST

(1) Neither McGladrey & Pullen nor its subcontractors are controlling shareholders of any Federally insured depository institution or depository institution holding company;

(2) Neither McGladrey & Pullen nor its subcontractors have related entities except as disclosed below:

1133 Avenue of the Americas, New York, New York 10036
(212) 382-0024 FAX (212) 302-4259

Internationally Dunwoody Robson McGladrey & Pullen

Thacher Proffitt & Wood is affiliated with a Texas law firm, Whittenburg, Whittenburg & Schachter.

Amarillo National Plaza Two
500 South Taylor
12th Floor
Amarillo, Texas

Thacher Proffitt & Wood owns a financial services consulting firm, Hudson Group.

11 Maritime Avenue
8th Floor
White Plains, New York

Mabon, Nugent owns the following related entities:

Mabon Nugent & Co. ("MN&Co.")*

- A New York Limited Partnership formed June 26, 1946
- This is the registered broker-dealer entity in which our primary business is conducted

Mabon Nugent Money Market Instruments & Co. ("MMI")*

- A New York Limited Partnership formed March 14, 1977
- An unregistered broker-dealer in which the government securities operations were conducted prior to the Government Securities Act of 1987. Since June of 1987 the government operations have been conducted in Mabon, Nugent & Co. The Toronto office ceased doing business as of December 6, 1989. The Ontario registration license was relinquished on December 31, 1989.
- A NYSE Approved Person

Mabon, Nugent Realty*

- Real estate brokerage license is located in this entity - Mabon Nugent Realty, a Division of MMI
- License effective May 27, 1988

Mabon Nugent International**

- A U.K. subsidiary 99% owned by MN&Co
- An inter-dealer broker of European debt securities
- Formed June 29, 1978
- Regulated by The Securities Association in London
- A NYSE Rule 322 guaranteed subsidiary

Mabon Nugent Gilts**

- Gilts is a subsidiary of Mabon Nugent International. It ceased doing business on December 31, 1989. It will remain as a shell corporation.
- Formerly a broker of Gilts in London
- Formed October 3, 1986
- Previously regulated by the Bank of England
- A NYSE Rule 322 guaranteed subsidiary

Mabon Nugent International Equities**

- A U.K. corporation 100% owned by Mabon, Nugent Equities & Co., L.P.
- An inter-dealer broker of European equity securities
- Formed February 28, 1984
- Regulated by The Securities Association in London
- A NYSE Approved Person

Mabon, Nugent Equities & Co. L.P.*

- A Delaware limited partnership
- Formed March 9, 1988
- NYSE Approved Person
- Owns 100% stock of Mabon, Nugent International Equities

MMI Limited**

- A U.K. subsidiary wholly-owned by MN&Co.
- A service subsidiary formed to hold equipment leases for Mabon, Nugent International
- Formed June 29, 1978
- A NYSE 321 Affiliated Company

Mabon Nugent Advisors, Inc.*

- A wholly-owned corporate subsidiary of MN&Co.
- Formed January 2, 1985
- A Registered Investment Advisor
- A NYSE Approved Person

Trinity Place Advisors, Inc.*

- A Delaware corporation
- A wholly-owned subsidiary of MNI
- Formed January 2, 1985
- Acts as a General Partner in certain limited real estate transactions for the Real Estate group of the Investment Banking Department
- A NYSE Approved Person

MN Realty Investors, Inc. - 88*

- A Delaware Subchapter S Corporation directly owned by certain partners of MN&Co.
- Formed April 26, 1988
- Intended to act as a General Partner in real estate transactions conducted in 1988
- A NYSE Approved Person

* One Liberty Plaza
New York, New York 10006

** Lloyds Chamber
1 Portsoken Street
London, England

(3) No related entities, as disclosed above, have been or are directors or officers of an insured depository institution or depository institution holding company, except that George Whittenburg and Mack Whittenburg, of the law firm of Whittenburg Whittenburg & Schachter, currently serve as directors of Western National Bank and City National Bank, both of Amarillo, Texas. These banks are subsidiaries of Amarillo Western Bancshares, Inc., a holding company that is owned and controlled by other members of the Whittenburg family.

(4) There is no competing property of McGladrey & Pullen or its subcontractors relating to the valuation, disposition, or management of real estate.

(5) We have no information regarding McGladrey & Pullen or its subcontractors which, in our opinion, could adversely affect ability to perform under the contract or to represent the RTC.

(6) McGladrey & Pullen has no organizational conflict as a result of the contractor' interests, relationship, or other RTC contracts. Further, we have obtained certifications from related entities that no such organizational conflict exists.

1606.7 PERSONAL CONFLICTS OF INTEREST

(1) McGladrey & Pullen and its subcontractors have no management officials or key employees with personal conflicts of interest.

(2) McGladrey & Pullen and its subcontractors have no loans, employment by, or ownership interest in the depository institutions whose assets are the subject of the contract.

(3) There are no financial, business, or close personal relationships with any person or entity, who to our knowledge, have an interest in the assets which are the subject of the contract, including information about negotiations or arrangements for future employment with such person or entity.

(4) McGladrey & Pullen and its subcontractors are not aware of any instance in which there was a default on any material obligation to an insured depository institution.

(5) McGladrey & Pullen and its subcontractors have no management officials or key employees that have an interest that conflicts with the responsibilities to the RTC.

Sincerely,

McGladrey & Pullen

/at-RTCCERT

Senator WIRTH. This is their statement that they have no conflicts of interest whatsoever and no reference was made to the 1985 suit and settlement.

You tell us that the amount they were involved with in the settlement was very small? Is that settlement a matter of public record?

Mr. ROELLE. I do not know, sir. I'm advised of this only in the notes that I've received.

Mr. SEIDMAN. I guess we've got to go another layer down.

The CHAIRMAN. Mr. Wright, why don't you come up and take another seat here.

Senator WIRTH. I'm not assuming, by the way, that there is anything wrong. I just want to make sure that we know that there was an absolutely clear trail running all the way through this, that you knew all about it and that, therefore, you looked at the other companies that were involved in this.

Mr. SEIDMAN. This is Mr. Lou Wright, who is working with Mr. Roelle in these areas.

Senator WIRTH. You're familiar with this letter, Mr. Wright?

Mr. WRIGHT. Yes, I am.

Senator WIRTH. Is it appropriate that a firm like McGladrey and Pullen would tell you in their conflict of interest statement, which I gather they're required to submit by law, that they say they have no conflict of interest. And none of their subcontractors have a conflict of interest.

Would you assume they would mention anything like this in there, or not?

Here you are charged by the FSLIC that you conducted a fraudulent audit of a savings and loan in California that, at the time, was the largest thrift failure. Maybe, it's not appropriate to mention it in the disclosure.

Let me ask you this. How did you find out about this history?

Mr. WRIGHT. I'm not 100 percent sure that we are talking about the same case. McGladrey and Pullen disclosed current and potential claims by any of the insurance funds. And we ran a check with the FDIC on the commercial bank side and the FDIC lawyers who are handling the thrift side to see if there were any active or potential claims by the insurance funds, as required by FIRREA.

Senator WIRTH. So, your check, as far as you know, did not go back to the 1985 charge by the FSLIC that this firm conducted a fraudulent audit?

Mr. WRIGHT. If it was settled before the FDIC became involved under FIRREA, I am not sure that we would have known about it. And it did not go back that far.

Senator WIRTH. Could you check that out for the record? It strikes me that this is the sort of thing that ought to be a matter of public record, that, ultimately, this sort of thing has a way of surfacing as it has through the diligent work of the Banking Committee staff. We ought to make sure that this is all well understood and that their compliance with the conflict of interest requirement has not in any way, shape or form been violated or would not be questioned because of the 1985 issue.

Would you check that?

Mr. SEIDMAN. We will certainly check that for you, Senator. I think, in general, we have taken the view that if there is no determination that there was fraud and there is a settlement, that that does not disqualify an institution if it's finished before this starts.

But, you raised a very good question.

[The following information was subsequently submitted for the record:]

Resolution Trust Corporation
Washington, DC 20434

L. William Seidman
Chairman

October 4, 1990

Dear Senator Wirth:

During my testimony before the Banking Committee on September 20, 1990, I was asked certain questions relating to one of the Resolution Trust Corporation's contractors that performed the review of the 1988-1989 Federal Savings and Loan Insurance Corporation Assistance Agreements. Specifically, you and Chairman Riegle asked for information on the public accounting firm of McGladrey & Pullen and their settlement of litigation brought by FSLIC as receiver of San Marino Savings and Loan Association. You also inquired why that settlement was not disclosed in the contractor registration material submitted by McGladrey & Pullen.

According to information retained by the Federal Deposit Insurance Corporation, as successor to FSLIC, and from information provided by McGladrey & Pullen, the litigation in question was settled out-of-court on October 27, 1987. Under the terms of the settlement, FSLIC received $11.75 million.

The lawsuit was filed by FSLIC on May 3, 1985 in the United States District Court, Central District of California. In filing the lawsuit, FSLIC contended that if McGladrey, Hendrickson & Pullen, as the firm was then known, had properly audited San Marino's 1982 financial statements and alerted San Marino's Board of Directors to the massive losses being incurred in its dealings with two of its principal borrowers, further loans to these borrowers would have been stopped and substantial losses would have been avoided.

McGladrey & Pullen apparently did not disclose the existence of the lawsuit or the settlement with FSLIC because disclosure is not required by Part 1606 of the RTC's Rules and Regulations. These regulations concern the registration, qualifications, and conflicts of interest requirements for contractors wishing to conduct business with the RTC. In effect, these regulations do not deem the settlement of a claim to be a loss to the insurance fund or the RTC. We believe, however, that it is important to know about past lawsuits and settlements. Thus, we intend to revise promptly our registration forms and procedures to provide for such disclosures.

We appreciate your interest in this matter, and if we may be of further assistance, please let me know.

With best wishes.

Sincerely,

L. William Seidman
Chairman

Honorable Timothy E. Wirth
United States Senate
Washington, D.C. 20510

Senator WIRTH. Let me ask you just as a follow-on to that.

In addition, we ran a check of this firm and other contractors, and the RTC's list of lawsuits also indicates that the RTC has a suit pending against Maben, Nugent and Company involving the failure of Imperial Savings and Loan.

I bring this up because Maben, Nugent is one of the subcontractors that McGladrey and Pullen hired to work on the review of the 1988 deal.

Were you familiar with that?

Mr. ROELLE. No, sir, I was not. It is possible that this was a lawsuit that was instituted by Imperial at some point prior to the RTC involvement and there may not, in fact, even be a settlement or a decision in that lawsuit.

In many cases—yes, sir?

Senator WIRTH. The document you submitted to us on July 12 has the RTC as the conservator for Imperial versus Maben, Nugent and Company. So, it's the RTC as conservator versus Maben, Nugent.

Mr. ROELLE. We succeed to all lawsuits that may have been filed by any institution that goes into conservatorship. We automatically become a party to the lawsuit.

Senator WIRTH. If there were a lawsuit by the RTC against a company like Maben, Nugent, would Maben, Nugent's then involvement in this kind of a study suggest any kind of conflict of interest?

Mr. ROELLE. Not necessarily, no, sir. It would depend on the situation. We would look at it, but it doesn't necessarily—it could be a lawsuit over some sort of matter that occurred in the institute, between that organization and the institution, that would not necessarily constitute a conflict of interest.

Mr. SEIDMAN. But, under our rules, it would be reviewed.

Senator WIRTH. I understand. I just wanted to see if it was reviewed and if you did know about it. Again, going through McGladrey and Pullen's quite lengthy statement, they made no reference to the 1985 issue with the FSLIC, which may have been dismissed and they were not involved. It was a charge, as far as I know, and our document indicates that it was settled. They may not have been culpable in any way, shape or form.

Then, there is no problem. And the same with Maben, Nugent. It may be that this was nothing but some harassment.

The question I raise is:

Would it be appropriate for them to include that in here? And, if not, let's make sure that we thoroughly understand everything so the decks are cleared. If they are cleared, then there's no problem, and we can all go ahead and have the kind of faith in the RTC study.

I thank you very much.

Mr. SEIDMAN. Thank you, Senator.

Senator WIRTH. Might I, Mr. Chairman, submit for the record and make sure that they are in the record, one, the letters that you, Chairman Sasser and Chairman Byrd, sent to Secretary Brady.

Second, his response to you in which he said there were a variety of options but did not request any specific option.

And then, third, your letter of September 13th back to Mr. Brady, when you invited him to come to the hearing.

And you said in that letter:

> At that same hearing, I would also appreciate your testimony on exactly which alternative the administration prefers and what legislation it believes Congress should enact to secure adequate funding for the Resolution Trust Corp.

As far as I know, we have not received—a specific reply.

The CHAIRMAN. Both will be made a part of the record.

[The following material is submitted for the record:]

DONALD W. RIEGLE, JR., MICHIGAN, CHAIRMAN
ALAN CRANSTON, CALIFORNIA
PAUL S. SARBANES, MARYLAND
CHRISTOPHER J. DODD, CONNECTICUT
ALAN J. DIXON, ILLINOIS
JIM SASSER, TENNESSEE
TERRY SANFORD, NORTH CAROLINA
RICHARD C. SHELBY, ALABAMA
BOB GRAHAM, FLORIDA
TIMOTHY E. WIRTH, COLORADO
JOHN F. KERRY, MASSACHUSETTS
RICHARD H. BRYAN, NEVADA
JAKE GARN, UTAH
JOHN HEINZ, PENNSYLVANIA
ALFONSE M. D'AMATO, NEW YORK
PHIL GRAMM, TEXAS
CHRISTOPHER S. BOND, MISSOURI
CONNIE MACK, FLORIDA
WILLIAM V. ROTH, JR., DELAWARE
NANCY LANDON KASSEBAUM, KANSAS
LARRY PRESSLER, SOUTH DAKOTA
STEVEN B. HARRIS, STAFF DIRECTOR AND CHIEF COUNSEL
LAMAR SMITH, REPUBLICAN STAFF DIRECTOR AND ECONOMIST

United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510-6075

September 13, 1990

The Honorable Nicholas Brady
Secretary of the Treasury
Department of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary Nick

I very much appreciate your support for prompt enactment of legislation to authorize the Federal Deposit Insurance Corporation to increase deposit insurance premiums as necessary to protect the Bank Insurance Fund.

I look forward to working with the Administration on this issue. The purpose of this letter is to invite you to testify before the Committee on September 18, 1990, or at your earliest convenience, in room 538 of the Dirksen Senate Office Building at 10:00 a.m. on the bill I have just introduced in this area.

At that same hearing, I would also appreciate your testimony on exactly which alternative the Administration prefers and what legislation it believes Congress should enact to secure adequate funding for the Resolution Trust Corporation.

The Congress must act on both of these issues before we recess. Your testimony is vital to ensuring prompt enactment and I look forward to working with you.

Sincerely,

Donald W. Riegle, Jr.
Chairman

Senator WIRTH. It's terribly important that we all understand this, so that we understand what happened and when. Statements were made earlier today, for example, that one of the reasons that many of the 1988 deals were put together at the last moment was that Congress had not provided the necessary funding to the then FSLIC. That's why they had to do the deal.

You'll remember that statement being made earlier today.

The record will show that that simply is not the case. We had up here testifying before the committee, Mr. Gould, the Deputy Secretary of the Treasury.

When asked directly by this Senator and others if they needed more money, he said: No.

Danny Wall came up to testify before this committee and was asked very bluntly during 1988 if they needed more money.

He said: No.

Now, the administration did not make any requests of us. Now, to have the argument be made that they had to make all of these questionable deals in 1988 because we hadn't given them money, is simply not accurate. And it is imperative that we make sure that:

One, that historic record be made clear.

Second, that we assure, Mr. Chairman, that this not happen again in 1990.

And I do not want us to be kept in a situation that, if there are problems and you have to shut down part of your shop—and I've said this before—if we do not have a request from the administration, if the Congress doesn't act because there's no request from the administration—then somebody says, well, the Congress didn't act.

Well, we had no request from the administration. So, we want to have that. Anything you can do, Mr. Seidman, to help us do that, as the chairman said, pushing up from below, we'll try to put the pressure on them. We'll ask them again, and we must get that information.

Mr. Chairman, you have been very generous with the time and I thank you very much. And I appreciate the testimony of your associates, Mr. Seidman. We look forward to your looking at these.

We've got all the documentation. I'm sure you can check it out very quickly.

Mr. SEIDMAN. Senator, I'd like to have permission. I'll send you a letter and try to give you everything we know about those two transactions.

Senator WIRTH. Absolutely.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wirth. I'll come back to that. I've got a couple of other key items here.

First, just as a follow-on to what you've said, when George Gould testified here on August 2, 1988, this is what he said:

> In closing, I urge this committee in the strongest possible terms to resist mounting pleas for an unnecessary budget-busting bailout of FSLIC. The precious resources of our taxpayers should not be tapped until the existing plan has had a chance to work and all other reasonably available resources have been used. In any case, no single change in existing mechanisms should be made without reevaluating the full array of institutional arrangements.

Well, that's sort of I think bureaucratic jargon. The fact of the matter was we were in deep trouble. Money was needed to do some-

thing about it; it was papered over at the time. And that is just shoddy testimony from the person at the time who should have been in the position to know better, and probably was.

But, that aside, you mentioned in this McGladrey and Pullen situation that it is your understanding that the settlement amount was de minimis.

I want to know what the figure was. Do you know?

Mr. ROELLE. No, sir.

The CHAIRMAN. Would you get the figure and report it to the Committee?

Mr. SEIDMAN. To the extent we'll have it, we'll give you all the information we have on the transaction.

The CHAIRMAN. I want to know the figure. If there's a problem in getting the figure, tell us what it is because I want to penetrate that and find out what that figure is.

And I have no reason to judge that it's not de minimis, but that's why I want to know the number.

Chairman Seidman, you've been very candid with this Committee about the real estate problem in the country. And you've got that map that you've shown us from time to time. And every time I've seen it, the number of States in the danger zone or the distress zone in terms of a fall in real estate values has gone up in size.

I just would like while you're here now:

What's your current reading of this spreading, whatever, spreading nature there is to the real estate problem in terms of a continued erosion in real estate values? And how much does that now cover of the country as a whole versus areas that seem to be immune from it?

Mr. SEIDMAN. The last map, Mr. Chairman, was somewhat mixed compared with the previous maps that we've shown you. The east coast continued to show erosion. All the States on the east coast continued to show erosion in that the banks continued to show increasing, nonperforming loans.

That was true all up and down the East Coast.

On the other hand, the Mid-West and, in general, showed a mixed trend, with a number of the States showing small improvements.

So, the general trend which had been showing in the Mid-West also getting a higher percentage of nonperforming loans actually in the last map was somewhat neutralized. The West continued to show strong performance without a large number—without any increase in nonperforming loans.

However, I have to point out that our maps are probably 120 days late in terms of what is actually happening, because they have to be nonperforming, and then they have to get into the records.

And between the two, it probably takes 120 days, at least. And our report did say that there were still very large increases in real estate lending in the Western States. And that, of course, is still a matter that needs to be closely monitored.

So, the real estate—and this is primarily commercial real estate that's involved in these—continues to erode on the east coast and, overall, the nonperforming again went up by about 15 percent and reached record highs.

The CHAIRMAN. In the BIF fund, according to the audit at the end of last year, there was about $13 billion left as of the end of December. I know there has been some drawdown on that. You have got money coming in and money going out.

Can you give me an approximate figure as to where the balance would be today?

Mr. SEIDMAN. Well I think it would be down somewhere between $1 and $1.5 billion.

The CHAIRMAN. From the $13 billion?

Mr. SEIDMAN. From the $13 billion.

The CHAIRMAN. So it would be $11.5 to $12 billion at the present time?

Mr. SEIDMAN. $10.5 to $11 billion.

The CHAIRMAN. $10.5 to $11 billion. Excuse me.

As you know, I have drafted legislation to provide you with the authority to take insurance premiums above their current statutory peak, which you have already proposed to go into yourself.

We do not see that as a cure-all to the problems of the banking system by any means, and we will have other legislation that deals with the issue of Deposit Insurance changes and early intervention and things of that kind.

But I take it that you, as well as the President and the Treasury Secretary, favor the notion of taking that cap off so that you have got the authority to raise premiums should you decide to do so?

Mr. SEIDMAN. Yes.

The CHAIRMAN. In terms of the amount of money that is left to work with at the RTC for the moment, you said that you had—did I understand you to say earlier, about $13 billion, as well, there, as your current operating balance or something close to that?

Mr. SEIDMAN. We had $13 billion at the first of the year. It has gone down by $1 to $1.5 billion.

The CHAIRMAN. I am talking about the RTC now.

Mr. SEIDMAN. The RTC? I am sorry, sir. We have about $13 billion left for resolutions.

The CHAIRMAN. Do you see that as holding, you say, through the end of the year? Is your operating plan clear enough say through the end of the year to let you know whether you are going to be able to operate?

Mr. SEIDMAN. I think our estimate is that things will become very tight before the end of the year.

The CHAIRMAN. What I am trying to determine, I mean these things are not perfect. You are obviously making estimates, but I am wondering if you need additional funds, or are likely to need additional funds between now and the end of the year. You cannot predict precisely?

Mr. SEIDMAN. We are likely to need some, but we will certainly need some when we move ahead into the next fiscal year.

The CHAIRMAN. I take it that we ought not to put off until next spring the notion that giving you additional resources to work with, I take your testimony today to be saying that however it is done, whatever amount and whatever the Treasury funding finally asks for, you would like to get that settled now before the Congress adjourns?

Mr. SEIDMAN. We need that now. We have to plan ahead on what we are going to do, and it is difficult enough to do if we know we have the resources.

If we do not know what resources we have, then it becomes much less efficient. So, yes, we will need funds by the end of the year, both working capital and early in the next year for losses. So we need action before the end of the congressional session, if at all possible.

The CHAIRMAN. Of the $110 billion that you estimated earlier that you need, it is my understanding that that is $50 billion for case resolutions, and roughly $60 billion for working capital?

Mr. SEIDMAN. Of the $50 billion, we need $40 billion during the next fiscal year. So it is actually $40 and $60 billion in the next fiscal year. $50 billion was the minimum we are going to need to do all the cases, and we think that is low, but that is at least the minimum that we would have to do.

The CHAIRMAN. So the working capital figure, then, looking forward, is roughly $60 billion. Is that correct?

Mr. SEIDMAN. That is correct.

The CHAIRMAN. And your presumption on that is that you will in effect get that money back, since that is a revolving fund? If you can get decent value on the assets that you have to dispose of that that $60 billion is money in? But then the money comes back out?

Mr. SEIDMAN. That is correct.

The CHAIRMAN. Now I am going to yield in just one second. I just want to nail down the money issues.

Senator D'AMATO. Mr. Chairman, if you might yield, I would just like to submit a statement for the record as if read in its entirety, as I have another committee hearing.

I am sorry I have not had an opportunity to get a chance to ask some questions, but I want to thank Mr. Seidman for his work in this area and for his candor, because he has been candid.

Hopefully we will have an opportunity to visit and get a little overview, and I thank the Chairman.

The CHAIRMAN. Very good, Senator D'Amato.

I should also indicate that Senator Dixon was here earlier and we will make his statement part of the record, as well.

[The prepared statements of Senators D'Amato and Dixon follow:]

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, thank you for convening this hearing today to examine the Federal Home Loan Bank Board's 1988 and 1989 deal structure. I am pleased to welcome this morning's witness, Mr. L. William Seidman, Chairman of the Oversight Board of the Resolution Trust Corporation. I look forward to hearing Mr. Seidman's testimony on this important matter, and so I shall be brief in my opening remarks.

I am pleased to see that today Mr. Seidman has brought with him RTC's report of its review of the 1988 and 1989 thrift-acquirer assistance agreements entered into by the Federal Savings and Loan Insurance Corporation.

Minimizing the public cost of the savings and loan crisis is of paramount importance not only to this Senator and this committee, but to the American taxpayer most of all. For those who ultimately will bear the cost of the S&L mess, every dollar counts.

Toward that end, the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989 requires the RTC to review and analyze the 1988–89 FSLIC assistance agreements and actively review all means by which RTC can reduce the costs of the agreements. The RTC's responsibility is a crucial one in that regard, and I value this opportunity to hear Mr. Seidman comment on RTC's progress.

Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR DIXON

Senator DIXON. Mr. Chairman, I would like to say that I am pleased to be here this morning, but I am not. We are here today to examine a policy catastrophe—the 1988 FSLIC deals. NASA has been in the news a lot lately; its competence and its ability to manage our space program are being questioned. Well, NASA is an award-winning success when compared to these deals. The 1988 deals demonstrate governmental incompetence on a scale and to an extent that is truly breath-taking. In fact, the 1988 deals would make a great "Saturday Night Live" sketch except for two things:

(1) Not even "Saturday Night Live's" audience would believe Government could be this bad—even worse than the worst governmental cynic could possibly imagine; and

(2) The huge losses the American taxpayer is taking on these transactions makes them anything but funny.

I have had a chance to review the RTC report. The report is a good one in some ways. However, I am greatly disappointed that the report fails to even provide a range of the tax costs involved in these transactions. After all, FSLIC was rushing to complete these deals in 1988 because certain tax benefits would expire at the end of that year. Tax considerations were very important to those who bought the insolvent thrifts from FSLIC. Yet the RTC report gives us nothing on that subject.

I hope the testimony this morning will give us some help as we attempt to see that this kind of disaster never happens again. I also hope this mornings hearing will help us answer the question of what to do now. In particular, I think the committee would appreciate knowing whether it makes sense to refinance the 1988 deals. I see from the report that there are some savings. I would like to have the benefit of RTC's view as to whether those savings are significant enough, both on a present value basis and a cash basis, to make refinancing an option we should be pursuing.

These transactions represent a kind of financial toxic waste dump. This hearing will have been a great success if, at its conclusion, we have some idea of how to clean it up, or at least how to quarantine it so it does not contaminate future problems.

The CHAIRMAN. Senator D'Amato, did you have a question you wanted to ask Mr. Seidman?

Senator D'AMATO. If it would not be imposing upon the chairman, I am certainly concerned about the impact on the economy. I have read a lot of the statements that have been made that, with the slowdown, that will exacerbate the problem.

I guess, Mr. Chairman, Bill, you would agree with that?

Mr. SEIDMAN. No question about it.

Senator D'AMATO. That is one of the reasons that I think we should be looking at, not withstanding our concerns as it relates to inflation, the very favorable impact that will take place and make the job a little bit better if we could get interest rates down.

In particular, that is going to save the American taxpayers a lot of money. Would you not say so?

Mr. SEIDMAN. Lower interest rates would be helpful.

Senator D'AMATO. I think that is important, and I think maybe, Mr. Chairman, in another session with the Chairman of the Federal Reserve we might just focus in on that impact as it relates to the RTC and the American taxpayers and it relates to interest rates.

I have again impinged upon your time, and I thank you for your courtesy.

The CHAIRMAN. Not at all. I am glad to you have you raise that issue.

So I draw from your testimony, Chairman Seidman, that the money that you need in the RTC you need to have available to you before the end of the year? You cannot do an absolutely precise cash flow, but you are saying to us, look, get this taken care of before the Congress adjourns so you are in a position to do your job.

Is that a fair statement?

Mr. SEIDMAN. We will be able to do our job much more efficiently if we have that money and to know what it is before the end of the fiscal year.

The CHAIRMAN. And if you do not have the money and you need it, then in a sense the costs go up, do they not? If you cannot step in on a timely basis, we end up having bigger losses? So the money has to be ready for you to use, because you need it.

Is that not correct?

Mr. SEIDMAN. That is correct.

The CHAIRMAN. Well, you have given us a pretty sober assessment today of the size of the requirements. I think it is very important that these get officialized by the Treasury Department and sent up to us in the amounts they want and over what time periods.

I think the minute we have that we will reconvene here to take care of that. The summit in fact may be talking about this; I am not sure.

I am not a part of the summit discussions on the budget, but in terms of deciding how much is to be provided with what kind of oversight requirements, that is something we will have to look at here and decide.

We want you to have the resources that you need, and we want you to have them on a timely basis—not just the dollar resources to handle cases, but also the personnel that you need and the other backup and support that you need.

I am going to just ask you, finally, just give me a one- or two-liner on what happened to this auction. We had Kelly in here with a couple of your associates, and everything was fine and dandy.

We were told the thing was going to go ahead, and lo and behold it collapses in the time sense. I am just wondering how we could have gotten that report that everything was fine, and then have it sort of disappear into thin air.

Mr. SEIDMAN. The contract provided that the auction company would provide a certain amount of dollar funding to pre-sell in the auction and under the contract. They provided 70 percent; we provided 30 percent.

Thanks to you and the Congress, we could provide our 30 percent. They were unable to come up with their 70 percent. As a result of that, the funding for the pre-selling, which is absolutely necessary, was not available. In our view, they breached the contract.

Once that took place, we sat down with them to see if we could remedy it and we found no way.

They indicated that they had searched for funding and had not been able to find it. As a result of that, the contract had to be terminated.

That means that we will have to go forward with other ways of selling this property. So it is unfortunate. It raises a question in my mind of whether we did a sound job of picking the parties that we did pick to do this auction.

So I think even though the contract in my view was terminated by them, nevertheless I think we have to look at our procedures for selecting the parties we use.

The CHAIRMAN. Let me raise one other thing with you. That is, we also had a discussion the other day with your folks in this area with respect to how we dispose of these assets in a slack real estate market. How do we get decent value, and how do we recover as much as we can for the taxpayers?

A lot of this property of course is within the State of Texas. About 70 percent of the dollar value of RTC assets are within a single State—namely, Texas. There are some scattered around the country, but they are concentrated very heavily there.

When you are trying to sell assets in the face of a very depressed real estate market and you are getting a low-dollar value, if you can sell it at all, maybe 10 cents on the dollar, or 15 cents on the dollar, I do not know quite how one would even score it—I am wondering in a case like that where we are trying to shove assets out into a very adverse market condition, I mean these are assets the public now owns.

So over some period of time we want to get as much value out of the assets for the taxpayer as we can. I am wondering, rather than selling some of these assets at fire sale price to whomever will take them, a foreign buyer or anybody else, if we would not be better off in some instances trying to get even a single tenant in a commercial building, even at a cut rate, so that they are on the premises to sort of watch the place and maintain it for us and wait for the real estate values to stabilize or come back some so that we might be able to sell at a more opportune time and realize a better price and

just give the taxpayer a better value on the disposition of the assets?

I realize it is a very difficult call. The other side of the coin is, you know, you get rid of the asset and you get it back into private hands. Somebody does something with it, and they maintain it, and they start paying taxes and so forth.

But when you have got so much you have got to shove onto an unwilling market, I am just wondering if there is not some way in which we ought to be thinking about how we over time could perhaps realize a higher dollar value for the taxpayer and not just take a distress price that helps a single buyer, but in effect leaves the taxpayer short-handed?

Mr. SEIDMAN. Well, that is our Catch-22. No matter which way we do it, there are good arguments for doing it the other way.

The way we are trying to meet that problem now with substantial sales is by a bulk sales contract that in effect allows the private sector to take over and run the assets and allows us to get paid from whatever can be produced from the assets out of the bulk of the cash flow.

Then it allows the buyer to get the principal benefits of any gain above estimated value, but it allows us to have some participation.

We would provide financing for that transaction. So it is something of a joint venture between us and the private sector.

We have tried to work that out. We have not yet received the approvals that we need for the financing part from the Oversight Board, but they are considering that at this time.

The CHAIRMAN. You have made a proposal to them?

Mr. SEIDMAN. Yes, and we are talking with them about it. Obviously they are concerned that the net result of this is not that we do all the financing and take most of the risk, and then the other people walk off with all the gains.

So we are trying to balance those two things.

That is a difficult thing to do with small pieces of property. But for the real bulk of what we have, we think that that is probably the method that can move the most now.

The difficulty with us hanging on to property is that those markets will never really stabilize as long as there is a huge overhang. Most of the people that we used to hear from telling us not to sell are pleading with us to sell now so they can stabilize.

As a matter of fact, those markets have improved somewhat as we have been feeding property into the market. So it is all a balancing act. I do not think there is any "right" answer.

The effort is to see what the market can absorb on a basis that gives the taxpayer the best break possible.

The CHAIRMAN. Thank you, very much. I will have some questions for the record from some other colleagues who were not able to be present.

We thank you again for your directness and leadership.

The committee stands in recess.

[Whereupon, at 12:40 p.m., the committee was adjourned, subject to the call of the chair.]

[Response to written questions and additional material supplied for the record follow:]

Report To The Oversight Board of the Resolution Trust Corporation and The Congress on the 1988/89 Federal Savings and Loan Insurance Corporation Assistance Agreements

Volume I

September 18, 1990

Resolution Trust Corporation

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EXECUTIVE SUMMARY

This is the first of two reports the Resolution Trust Corporation ("RTC") will be submitting to Congress and the Oversight Board of the RTC. This report focuses on the results and conclusions of the RTC's cost evaluation and cost reduction review of the assistance agreements entered into by the Federal Savings and Loan Insurance Corporation ("FSLIC") in 1988 and 1989. This report was prepared in accordance with the RTC's mandate defined in Section 501 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), which requires the RTC to:

- Review and analyze the 1988-89 FSLIC Assistance Agreements, and actively review all means by which it can reduce costs of the agreements.[1]

- Evaluate the costs under existing FSLIC agreements with regard to:
  - capital loss coverage,
  - yield maintenance guarantees,
  - forbearances,
  - tax consequences, and

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[1] RTC's outside counsel concluded that FIRREA does not grant RTC new legal rights to abrogate or repudiate unilaterally the FSLIC Assistance Agreements. See Chapter IV and Appendix IV.

- any other relevant cost consideration.

- Review the bidding and negotiation procedures used by FSLIC to determine whether they were sufficiently competitive.

- Report to the Oversight Board and the Congress the results and the conclusions of the review.

The second report on the bidding and negotiation process will be finalized and submitted to the Congress and the Oversight Board in the next two months.

The Review Process

The review was undertaken by five private sector groups under the direction of RTC staff. These groups included public accounting firms, law firms, investment bankers, consultants, and a public policy research group. The groups are identified in Chapter II. Each group reviewed one or more of the 96 transactions consummated in 1988 and 1989. The largest package of transactions for a single contractor included 40 transactions. The smallest package consisted of one transaction, which was the largest in FSLIC's history.

Each contractor submitted a general report on their overall

findings, conclusions and recommendations, as well as an individual report on each transaction reviewed (multiple transactions by a single acquirer were sometimes combined if the agreements with FSLIC were similar). The general reports and the individual reports are included in Volumes II through VII of the RTC's report.

It is particularly useful for the reader, in reviewing the discussions of "Forms of Assistance" and "Cost Reduction Opportunities," to have an understanding of two basic factors that drove the structure and timing of the FSLIC Assistance Agreements.

- First, the FSLIC was without the financial resources to efficiently absorb the losses and asset-carry needs it was facing. In short, it could not pursue a liquidation strategy where appropriate.

- Second, the tax benefits provided in the Tax Code were scheduled to expire December 31, 1988. This clearly increased overall activity during 1988. More important, with regard to the flurry of activity at year-end, were the provisions of the Technical and Miscellaneous Revenue Act ("TAMRA"). TAMRA extended the benefits beyond 1988, but required that 50 percent of the amounts excludable under Section 597 of the

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Internal Tax Code (tax-free assistance) be applied to reduce certain tax attributes, e.g., net operating losses, deductible interest expense and built-in losses.

Forms of Assistance

The forms and amounts of assistance granted vary widely, and no two transactions were exactly alike. However, each assistance agreement was, for the most part, built around a framework of several basic provisions which were dictated by the size and complexity of the acquired institution. In general, acquired institutions shared two fundamental characteristics: they were book insolvent, that is, their liabilities exceeded the book value of their assets, and the true value of their assets was less than as stated on their books. Without cash, FSLIC's general approach was to provide high yielding notes to eliminate the book insolvency, and to guarantee yields and loss protection on those assets whose value was suspect. Additionally, in a number of transactions, indirect assistance in the form of tax benefits not recaptured by FSLIC is substantial. The forms of assistance granted included:

- Cash payments. Payments in cash were made to offset the negative net worth of the failed institutions

acquired.

- Promissory notes. Like cash, notes were given to offset negative net worth. The notes varied in maturities and other terms. Generally these notes are high yielding, paying interest based on a cost of funds index plus a spread to cover operating expenses.

- Capital loss protection. This type of assistance protected the acquirer from any capital loss incurred by the disposition of covered assets -- troubled loans, real estate, and other risky assets. Sometimes gains and losses were shared between FSLIC and the acquirer.

- Guaranteed yield maintenance. This assistance is paid to guarantee that the acquirer would earn a minimum return over a base rate on covered assets. The base rate usually declines over the life of the agreement. In most cases the guaranteed yield is markedly higher than the institution would receive from the market investment of the sums equal to the book value of the covered asset.

- Indemnification and reimbursement for losses. This assistance is paid to reimburse acquirers for unreserved claims brought against the acquirer because

of the transaction or against the acquired assets, and to cover expenses related to such claims.

- Other direct forms of assistance. Assistance is also paid to reimburse acquirers for goodwill created by the transaction, and for expenses associated with paying off high cost liabilities acquired in the transaction.

- Forbearances. The Federal Home Loan Bank Board usually entered into separate agreements allowing acquirers to: (1) operate with capital below regulatory standards for various time periods; (2) pursue activities not normally permissible; and (3) correct violations of regulations created by the assisted acquisition over various time periods.

- Tax benefits. Assistance payments by FSLIC are not considered taxable to the acquirer. This indirect assistance is significant to acquirers with other profitable lines of business. FSLIC normally recaptured all or a portion of the tax benefits under tax-sharing provisions in the agreements.

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Categories of Assistance Transactions

The 96 assistance agreements entered into by FSLIC in 1988 and 1989 resulted in assistance payments being provided to 91 different resulting institutions. For purposes of this review, RTC separated the assistance agreements into five categories based on the type of assistance granted, the amount of covered assets, and whether or not the institution is now under the RTC or FDIC's control. These categories, and the number of transactions in each, are as follows:

- Cash transactions. These transactions consisted of cash payments and indemnities. There is no material ongoing exposure in these transactions. Twenty-five of the 96 transactions are considered cash transactions.

- Small transactions. The acquirers in these transactions have minimal amounts of FSLIC promissory notes and covered assets (under $50 million). RTC may be able to buy out these agreements for a relatively small outlay without having a material adverse impact on the institution. Twenty-six transactions meet this definition.

- Large transactions. The acquirers in large transactions have covered assets on their balance

sheets of between $50 and $500 million, or large amounts of promissory notes. The agreements are usually very complex. Eighteen transactions meet this definition.

- Mega transactions. The 14 transactions considered mega transactions resulted in thirteen institutions. Each of these institutions has covered assets in excess of $500 million. Assistance payments in these cases are estimated to exceed $500 million per transaction.

- Transactions under government control. The 13 transactions under this category were consummated with 12 institutions that never left the FSLIC's effective control or are now effectively controlled by the RTC. These cases include five stabilizations (transactions where the resulting thrift is a mutual institution), five institutions placed into conservatorship or receivership subsequent to FIRREA, and two institutions (three transactions) where the parent thrift has been placed in conservatorship or receivership.

Cost of Assistance

RTC's contractors estimate that the total cost of assistance

in the 96 transactions, assuming no changes in terms, is likely to exceed $69 billion. The cost estimates for each category of transaction is included in the following table.

Estimated Cost of Assistance
($ millions)

Transaction Type	Net Cash Payments Prior to 1/1/90	Net Cash Payments After 12/31/89	Net Cash Payments Total*	Present Value After 12/31/89
Cash	$ 324.1	$ 1.7	$ 325.2	$ 2.3
Small	649.9	686.9	1,336.8	426.5
Large	1,209.5	6,021.5	7,231.1	4,471.1
Mega	2,856.5	39,057.7	41,914.8	24,918.2
Government Control	2,132.0	16,678.7	18,809.9	11,226.0
Totals	$7,172.0	$62,446.5	$69,617.9	$41,044.1

* - may not add due to rounding

These cost estimates are subject to significant change due to fluctuations in interest rates, market conditions and the timing of losses. These estimates do not include estimates of tax revenues forgone by the Treasury because of the uncertainties related to the ability of the acquirers to use the benefits, as well as the timing of their use. In many cases tax returns have not been prepared, and in some of the cases where internal estimates had been prepared, they were not provided to RTC contractors. For these reasons, tax revenue losses are not subject to reasonable estimation. In most cases, estimates of

tax benefits shared with FRF were estimated. In total, these shared benefits do not materially affect cost estimates.

Included in the table are cost estimates for cash and note assistance given to fill the negative net worth hole of the acquired institutions. This assistance, along with capital loss coverage, totals approximately $35.5 billion. The costs associated with this assistance are sunk costs, since they were embedded in the failed institutions.

The other two principal cost items are yield maintenance and interest on the notes. These costs total $34.2 billion and are essentially carrying costs on the notes and the bad assets. These direct costs to FRF could be substantially reduced or eliminated if the notes are repaid or the covered assets repurchased. The carrying costs would then be transferred to the Treasury as interest on the debt incurred to provide the cash needed to prepay notes and purchase covered assets.

Options for Consideration

The review undertaken to date provides the RTC with a number of options for moving forward in consultation with the Oversight Board and the Congress. The RTC contractors identified various opportunities for reducing the cost of assistance agreements.

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These opportunities and potential cost savings are:

- Prepayment of FSLIC promissory notes. By beginning prepayment of approximately $11.3 billion in notes in 1991, the FSLIC Resolution Fund could save potentially $540 million on a present value basis. The conversion of tax-free income to taxable income could potentially save the government as a whole an additional $550 to $650 million on a present value basis. Total savings could be $1.1 to $1.2 billion on a present value basis.

- Prepayment of American/New West intercompany note. If FDIC directed New West FS&LA, Stockton, California, to prepay its intercompany note with American Savings Bank, FA, Stockton, California, at the earliest opportunity, the government as a whole could save approximately $520 million on a present value basis.

- Prepayment of FSLIC promissory notes held by institutions controlled by FDIC and RTC. If $4.9 billion in notes held by three of the 13 institutions under government control were prepaid, savings could approximate $37 million per year, due to the difference in rates available on Federal Home Loan Bank advances and rates on short-term Treasury securities.

- Write-down of covered assets to fair market value. Writing down covered assets by approximately $3.8 billion in 1991 could save FRF $285 million on a present value basis, and the government as a whole an additional $250 million. Total savings on a present value basis is estimated at $535 million.

- Purchase of selected covered assets. Savings from the purchase of raw land, junk bonds, and participation loans could be significant, but was not estimated.

- Restructuring agreements to improve disposition incentives. All RTC contractors recommended assistance agreements be renegotiated to provide incentives for acquirers to rapidly dispose of covered assets.

- Buy-out of smaller transactions. A total buy-out of small transactions where solvency would not be an issue could eliminate the significant ongoing costs associated with oversight and monitoring requirements.

Tax Issues

RTC's contractors recommended that Congress and/or the appropriate authorities clarify certain tax issues which could

have significant cost ramifications on the Treasury and the acquirers. The two principal issues concern built-in losses and tax-sharing agreements.

- Built-in losses. One RTC contractor concluded that there does not appear to be a statutory basis for acquirers deducting built-in losses on their tax returns, if they receive capital loss coverage that reimburses them for the economic loss suffered. The memorandum explaining these findings is included in its entirety as Appendix V to this report. Clarification of the proper tax treatment for built-in losses by the Congress and the appropriate authorities is critical. Direct capital loss payments under the assistance agreements reviewed exceed $11.5 billion.

- Tax-sharing agreements. Questions were raised about tax-sharing arrangements at thrifts owned by corporate parents. In many cases tax benefits are passed up the corporate ladder and used to shelter taxable income generated by other affiliated entities. While this was expected when the transactions were negotiated, in some cases the thrift is not being reimbursed by the parent company for the share of the benefit paid to FRF by the thrift. It was recommended that FDIC and OTS review all tax-sharing arrangements for their effect on the

safety and soundness of each subject thrift.

It was also pointed out that when FRF holds warrants in a resulting thrift, it has not ratably shared in the benefits created by in-substance dividends being declared. It was recommended that FDIC review all tax-sharing arrangements where it holds warrants or other equity interest.

Survivability Issues

A review undertaken by the Office of Thrift Supervision concluded that the prepayment of notes and/or repurchase of covered assets would have a material adverse impact on numerous thrifts. Their analysis grouped each of the 87 institutions they reviewed into one of seven groups based on the impact the elimination of covered assets and/or FSLIC promissory notes would have.

Of particular importance was the estimate that the call or prepayment of notes and/or covered assets and the attendant yield guarantees would likely precipitate the eventual insolvency of 17 institutions with $51 billion in assets. These findings are more fully discussed in Chapter IV.

Conclusion

In moving forward, the RTC will continue to refine the cost savings estimates with its contractors and the acquirers. RTC will also confer with the IRS and the Treasury regarding possible savings resulting from different or clarification of existing tax treatment as discussed in this report.

Potential Cost Reductions From the Unilateral Exercise of FSLIC Rights

Prepayment of FSLIC notes	$ 1.1 to 1.2 billion
Prepayment of New West intercompany note	520 million
Prepayment of notes at government controlled institutions	*
Write-down of covered assets	515 million
Total	$ 2.2 to 2.3 billion

* - approximately $40 million per year; total depends on final resolution of the institutions under government control.

For an additional budget outlay of approximately $5 billion in fiscal year 1991, exercising unilateral rights to prepay notes (including the New West/American intercompany note) and marking covered assets to estimated fair market value could potentially save the government as a whole $2.1 to $2.2 billion. The budgetary outlay is small relative to the potential savings due to the fact that the $16.6 billion in FSLIC promissory notes

purposes in the fiscal year in which they were issued. Accordingly, and more importantly, the cash needed to realize these savings would be approximately $18 to $20 billion in fiscal year 1991.

It is estimated that government-wide savings of an additional $1 to $2 billion could be realized from:

- purchase of selected covered assets;
- restructuring agreements through incentives to improve disposition rates and timing;
- total buy-out of smaller transactions; and
- reversal of current tax treatment with respect to the deductibility of built-in losses, where the government has compensated acquirers for their economic losses through capital loss payments.

Any such savings cannot be readily estimated, as they will be dependent upon renegotiations of contracts and consultations with the IRS.

CHAPTER I

INTRODUCTION

On August 9, 1989, President Bush signed into law the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Without question, FIRREA is the most comprehensive reform legislation of the thrift industry since President Hoover signed into law the Federal Home Loan Bank Act almost 60 years ago.

While the purposes of FIRREA are many and far-reaching, several of its provisions concern the cost and administration of assistance agreements with the acquirers of failed thrifts resolved by the former Federal Savings and Loan Insurance Corporation ("FSLIC") and the Federal Home Loan Bank Board ("FHLBB"). These provisions give overlapping responsibilities to a number of Federal agencies. For instance, while FIRREA established the FSLIC Resolution Fund ("FRF") as a separate fund to be managed exclusively by the Federal Deposit Insurance Corporation ("FDIC"), it requires the FDIC, the General Accounting Office ("GAO") and the Resolution Trust Corporation ("RTC") to report in one form or another on the cost of assistance agreements paid out of the resources of FRF.

In addition, FIRREA gives somewhat overlapping authority to RTC and to FDIC to modify, renegotiate or restructure FSLIC assistance agreements. Finally, FIRREA vested in the RTC Oversight Board the exclusive authority to determine whether RTC or FRF shall benefit from cost savings realized from the RTC's modification, renegotiation or restructuring of the FSLIC assistance agreements entered into between January 1, 1988, and August 9, 1989 ("FSLIC Assistance Agreements").

It is within the context of all of FIRREA that RTC has undertaken its review and prepared this first of two reports, which focuses on the results and conclusions of RTC's cost evaluation and cost reduction review of the Assistance Agreements required by Section 501(b)(11)(B) of FIRREA. Specifically, Section 501(b)(11)(B) requires that RTC:

(1) review and analyze all insolvent institution cases resolved by the FSLIC between January 1, 1988, and the date of enactment of FIRREA, and actively review all means by which it can reduce costs under existing FSLIC agreements relating to such cases, including restructuring such agreements;

(2) evaluate the costs under existing FSLIC agreements with regard to --

(A) capital loss coverage,

(B) yield maintenance guarantees,

(C) forbearances,

(D) tax consequences, and

(E) any other relevant cost consideration;

(3) review the bidding procedures used in resolving such cases in order to determine whether the bidding and negotiation processes were sufficiently competitive; and

(4) report to the Oversight Board and the Congress the results and the conclusions of the review.

The second of two reports -- on the bidding and negotiation process employed by FSLIC during 1988 and 1989 -- will be presented to the Oversight Board and the Congress soon. While the RTC's review is well underway, the volume of records being reviewed in order to come to a full understanding of the process necessitates a delay in reporting on this part of our review. The information reviewed in the cost evaluation portion of the study is, for the most part, distinct from that being reviewed for the bidding and negotiation process. Therefore, RTC does not believe the delay will detract from the content of this report.

Chapter II is a discussion of how the study was conducted. The accounting firms, law firms, investment bankers, consultants, and the public policy research group participating in the review are identified; the steps undertaken by each contractor to

develop their cost estimates and cost reduction recommendations are outlined; and an explanation of the focus of the study on cost savings is provided.

Chapter III includes general information about the FSLIC Assistance Agreements; a presentation of the more common types of assistance granted; the RTC's evaluation of the cost of the agreements; and a discussion of the progress made by assisted institutions in liquidating the assets which were guaranteed by the FSLIC. Also, the assistance agreements subject to our review are identified and categorized. Lastly, in an effort to put the cost estimates and liquidation results into perspective, we have included a discussion of both: (1) the incentives and disincentives for timely asset disposition embodied in the assistance agreements; and (2) the FDIC's monitoring and oversight role as successor to FSLIC. The context in which each of the assistance agreements was entered into will be reported in the RTC's separate report on the bidding and negotiation process.

In Chapter IV, RTC presents its conclusions on the review of the FSLIC Assistance Agreements. The rights granted to RTC under FIRREA and FSLIC's rights under the agreements are reviewed and summarized. This chapter includes a discussion of the opportunities available for reducing the costs of the assistance agreements, including discussions of the fiscal and budgetary ramifications associated with each opportunity. A number of tax

and regulatory issues are raised that require clarification by Congress or other appropriate authorities. Options for changes in the way the agreements are administered are discussed. The last issue contained in Chapter IV is the potential impact on the condition and viability of the resulting institutions if certain actions are taken by the government to reduce costs. The discussion on "survivability" includes certain summary information provided by the Office of Thrift Supervision ("OTS"). To conclude the report, RTC presents its list of options for reducing costs that should be considered for implementation.

Accompanying this report are the summary reports submitted by each RTC contractor, and the individual reports for the 96 FSLIC Assistance Agreements. The summary reports include the contractors' overall findings and general recommendations for realizing cost savings and improving the oversight and monitoring of the individual agreements. The individual transaction reports, attached in five separate volumes, explain the essentials of each transaction including the structure of the transaction; the terms of assistance; forbearances granted; tax consequences; the FSLIC's right to exercise options within the agreement; the actual costs incurred through December 31, 1989; the FDIC's and RTC's estimates of future gross cost of the assistance agreement; the RTC's estimate of the present value of future cost; the condition of the resulting institution; and individual recommendations for realizing direct cost savings.

CHAPTER II

THE REVIEW PROCESS

The RTC's review of the FSLIC Assistance Agreements began shortly after the enactment of FIRREA. Early staff efforts concentrated on the methodology for the review. By September 1989, RTC had decided that the review should be undertaken by outside consultants under the direction of RTC staff. The decision to use outside consultants was made in order to facilitate a timely, impartial and credible review. That decision is also consistent with the FIRREA requirement that RTC utilize the resources of private persons to carry out its duties when utilization of such services are practicable and efficient.

After consultation with the Oversight Board, the RTC's methodology for the review was incorporated into RTC Request for Proposals No. 2122 ("RFP") which was provided to over 100 interested parties beginning December 8, 1989. The RFP invited interested parties wishing to perform the actual reviews to submit technical and cost proposals by January 9, 1990. The submission date was later extended to January 23, 1990. Interested parties could propose to review up to three of a total of eight packages of assistance agreements. Each of the eight packages was compiled in an attempt to evenly distribute the

number of transactions based on complexity, location and common acquirers. Each package contained between 10 and 13 transactions.

In response to the solicitation, RTC received proposals on one or more packages from 18 different offerors. All proposals received were evaluated for technical factors including: (1) technical approach and understanding of the project; (2) personnel qualifications; and (3) organizational capability. Acceptable proposals were further evaluated for cost. Ultimately, the RTC Board of Directors authorized entering into contractual agreements with five different groups to perform the tasks required. The five groups engaged are listed in Exhibit I at the end of this chapter.

The goals of the contracts entered into between RTC and its contractors call for the contractors to present credible and impartial recommendations for reducing costs of the FSLIC Assistance Agreements. The recommendations were required to be presented on an institution-by-institution basis. These individual reports and the contractors' summary reports serve as the basis for this general report.

The work performed by each contractor included, but was not limited to: (1) an information gathering process; (2) an analysis of incentives; (3) a cost estimation process; and (4) the

development of recommendations for reducing costs. Upon completion of the above tasks, the contractors were required to submit draft and final reports detailing their findings and recommendations. While not required by FIRREA, the RTC required the contractors to report on and recommend improvements for the oversight and monitoring process. The individual reports prepared by each contractor are included as appendices to this report.

During the information gathering stage of the contract, each agreement was reviewed to achieve:

1) an understanding of the financial terms of the agreements, including capital-loss coverage, yield maintenance, tax benefits, equity participation, and any other provision affecting cash flows between the acquirer and the government;

2) an understanding of forbearances granted, including the type and amount of capital required to be provided by the acquirers;

3) a determination of what actions FDIC or RTC can and cannot take under the agreements to affect the government's loss exposure;

4) an understanding of any other terms of the agreements which might affect the loss exposure of either the Treasury, the RTC, the FSLIC Resolution Fund, or the insurance funds; and

5) tax implications.

Following the information gathering phase, contractors met with FDIC's oversight staff, on-site FDIC contractors, and management of the resulting institution. The contractors evaluated compliance with the agreements and liquidation efforts, and they categorized which provisions the acquirers would accept changing and those they would resist changing.

During the next stage, each contractor was required to look at the incentives and disincentives embodied in each agreement and to analyze how the provisions would encourage or discourage the resulting institution to minimize the government's cost of the assistance agreement. Provisions which may be structured to discourage the resulting institution from promptly liquidating covered assets include: (1) capital loss coverage; (2) yield maintenance; (3) mark-to-market provisions at termination; (4) gain sharing provisions; (5) management fees to related entities; and (6) tax benefit sharing.

The purpose of the analysis of incentives and disincentives

was two-fold. First, a complete understanding of incentives and disincentives is important to each contractor's evaluation of the acquirer's liquidation efforts. Second, such an analysis is a prerequisite to estimating the likely amount of yield maintenance and capital loss coverage over the life of each assistance agreement. Last, a full understanding of existing incentives is necessary to make credible recommendations for improving asset disposition rates and for oversight of the agreement.

During the cost estimation process, each contractor was required to prepare estimates of the cost of each assistance agreement both in actual and present value terms. Pursuant to instructions from RTC, each contractor's cost estimates were developed using consistent methods, logic and assumptions. The estimates were developed using as a base component the same model used by FSLIC in estimating the cost of the assistance agreements when they were originally consummated. The decision to use the FSLIC model was made jointly by the contractors after validating its applicability and logic. The RTC is comfortable with this decision, as the logic embedded in the FSLIC model has been validated by independent groups on a number of occasions since 1988.

In practice the FSLIC model was used to estimate only cash payments to assisted institutions for yield maintenance and capital loss coverage. Other components such as cash flows not

dependent on actual yields on covered assets, loss rates and asset disposition rates were modeled using a microcomputer spreadsheet program jointly developed by the contractors. The information generated by the FSLIC model was incorporated into the spreadsheet program, and all information was fed into a third model used to estimate the amount and timing of tax benefits generated under the terms of each agreement. This tax model was used to estimate the amount and timing of tax sharing payments returned to the FSLIC Resolution Fund under the tax sharing provisions of the agreements. The assumptions and support for all three models are attached as Appendix III to this report.

In undertaking the cost estimation process, contractors were instructed not to perform independent appraisals of covered assets or make their own independent judgements for the timing of such related losses. The contractors were instructed to rely heavily on existing estimates provided by acquirers that have been reviewed by on-site FDIC contractors and FDIC case managers and oversight staff. Existing cost estimates were subject to limited due diligence to check for reasonableness, and adjustments were required to be made by the contractors where appropriate. However, independent appraisals and audits of all the information required to be assembled in order to provide a truly independent estimate was deemed too costly and time consuming for the benefits that would have been achieved; therefore, they were not performed.

In establishing this scope limitation of the review, RTC took into consideration the ongoing reporting requirements on costs that FIRREA mandated of FDIC and GAO.[2] In performing its review, RTC concentrated on what we believe is the intended mandate of Section 501(b)(11)(B); that is, cost evaluation for cost savings, not cost estimating.

Lastly, the scope of RTC's contracts required contractors to make credible recommendations for reducing both direct and indirect costs of the assistance agreements. When making their recommendations, the contractors were instructed to consider all types of costs and all factors which affect costs. Each recommendation is required to be supported by a written cost benefit analysis and to be subjected, where appropriate, to a sensitivity analysis that will reflect potential savings under higher and lower interest rates, higher and lower asset collection scenarios, and faster and slower asset disposition assumptions. Where applicable, the cost benefit analysis must include estimates on savings or costs to both FRF and to the government as a whole.

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[2]Pursuant to Section 220(a) of FIRREA, the FDIC, as exclusive manager of FRF, is required to report on the condition of FRF including changes in the cost estimates of FSLIC Assistance Agreements. Also, Section 501(f) of FIRREA requires the GAO to report annually for each of the next three years on the cost of the FSLIC Assistance Agreements.

Exhibit I

RTC Review of the 1988–1989 FSLIC Assistance Agreements

Contractor	Type of Firm	Number of Transactions Reviewed
Price Waterhouse	Public Accounting Firm	40
Donovan Leisure, Rogovin, Huge & Schiller	Law Firm	
McGladrey & Pullen	Public Accounting Firm	25
Subcontractors:		
Thacher Proffitt & Wood	Law Firm	
Danielson Associates Inc.	Consulting Firm	
Melton Nugent & Co.	Investment Banking Firm	
Kenneth Leventhal & Company	Public Accounting Firm	17
Subcontractors:		
Arter & Hadden	Law Firm	
Kelly, Drye & Warren	Law Firm	
Coopers & Lybrand	Public Accounting Firm	13
Subcontractor:		
Arter & Hadden	Law Firm	
Mid America Institute for Public Policy Research	Public Policy Research and Educational Organization	1
Subcontractors:		
Smith Breeden Associates	Consulting Firm	
Coster & Gail	Law Firm	

CHAPTER III

THE 1988-1989 FSLIC ASSISTANCE AGREEMENTS

INTRODUCTION

An evaluation of the FSLIC Assistance Agreements to determine actions that can be taken to reduce costs requires an understanding of a) the various forms of assistance granted in 1988 and 1989, b) the complexity of the transactions, c) the estimated costs of assistance, including fixed and variable costs, d) the progress made by institutions in fulfilling their obligations to liquidate assets, and e) the role of the FDIC in administering the agreements. Each of these topics is discussed in this chapter.

DIRECT FORMS OF ASSISTANCE

The forms and amounts of assistance granted vary widely, and no two transactions were exactly alike. However, each assistance agreement was, for the most part, built around a framework of several basic provisions which were dictated by the size and complexity of the acquired institution. In general, acquired institutions shared two fundamental characteristics: they were book insolvent, that is, their liabilities exceeded the book

value of their assets, and the true value of their assets was less than as stated on their books. Without cash, FSLIC's general approach was to provide high yielding notes to eliminate the book insolvency, and to guarantee yields and loss protection on those assets whose value was suspect. Additionally, in a number of transactions, indirect assistance in the form of tax benefits not recaptured by FSLIC is substantial. We begin this chapter with a discussion of these and other forms of assistance provided by FSLIC.

NOTES OR CASH TO OFFSET NEGATIVE NET WORTH

FSLIC issued promissory notes and/or cash to the acquiring institution in the amount necessary to offset the negative net worth of the acquired institution. The notes bear interest at a stipulated base rate, usually the Texas Cost of Funds or another index, plus additional amounts ranging up to 260 basis points. These high yields were required due, in large part, to the high rates of interest the acquired institution was paying for deposits and borrowings. Paying off these high cost funds would have required cash instead of notes -- cash the FSLIC did not have.

In most cases, the FSLIC notes may be prepaid; in others, prepayment provisions are limited to timed, incremental pay-downs. The interest on the notes generally qualifies as

"assistance" income to the institutions and, as such, is excluded from taxable income.

COVERED ASSET PROTECTION

In virtually all of the larger transactions, the acquirer was protected from any capital loss incurred by the disposition of "covered assets". The acquirer was also guaranteed a minimum return or yield on the covered assets. That yield also was set so as to give the acquirer enough income to cover high funding costs as well as operating costs, including the management of the covered asset portfolio.

Typically, covered assets are those assets owned by the acquired institution which were classified as non-performing or troubled at the time of the transaction, or which were expected to become troubled within a specified period. In some agreements covered assets were limited to those specifically identified. In other agreements covered assets were identified by category. In these agreements, covered assets usually include some combination of the following:

- real estate owned;
- loans in various stages of default;
- delinquent loans, usually past due 90 days or more;
- non-investment grade securities; and
- investments in subsidiaries.

In general, it is safe to say that proper management of these types of assets would be time consuming and costly.

GUARANTEED YIELD MAINTENANCE

FSLIC agreed to guarantee that the acquiring institution would earn an agreed upon minimum return (guaranteed yield) on the book value of its covered assets. Thus, to the extent the guaranteed yield exceeds the actual yield earned by the institution, FSLIC is required to reimburse the difference to the acquirer.

Guaranteed yield rates and coverage periods vary depending on the types of assets. Similar to the rates on the promissory notes, guaranteed yield maintenance rates were based on a stipulated base rate (Texas Cost of Funds or another index) plus additional amounts ranging up to 275 basis points; in most transactions the additional basis points decline over the terms of the agreements.

Again, similar to interest on the promissory notes, the incremental guaranteed yield income on covered assets is not taxable to the acquirer.

It is important to note that in most cases the guaranteed yield is markedly higher than the institution would receive from

the market investment of the sums equal to the book value of the covered asset.

CAPITAL LOSSES AND GAIN/SHARING

A capital loss is: 1) the amount by which the net proceeds received upon sale or disposition of a covered asset is less than its book value adjusted for subsequent capitalized expenses; or 2) the amount of any write-down of the book value of a covered asset approved by FSLIC. Generally, acquirers are reimbursed for all or a major portion of capital losses on covered assets. In some cases the acquirers share in capital losses.

If the net proceeds in a covered asset sale or liquidation exceed book value or some previously established benchmark, FSLIC is generally entitled to all or a major portion (usually 80 percent) of those gains. Most agreements established gain-sharing benchmarks at or just below book value. However, in some transactions the benchmarks were established as low as 50 percent of book value.

The assistance agreements provide FSLIC the right to require write-downs of the book value of covered assets to fair market value or other basis, with the amount of the write-down being paid to the acquirers. In some agreements, write-downs are limited to a certain percentage of book value or by other

factors. Additionally, FSLIC generally has the right to buy back the covered assets at fair market value or book value, although some agreements restrict this right.

Any reduction in the amount of covered assets (either through write-down, buy-back, or disposition) reduces the base on which yield maintenance payments are calculated.

Losses due to the disposal or write-down of covered assets are generally tax deductible, while the reimbursement for losses and write-downs by FSLIC is not taxable to the institution.

The assistance agreements outline the criteria under which a covered asset may be sold. In general, an offer must be submitted by a qualified buyer and must be within a certain percentage of fair market value as established by current appraisal. FSLIC approval of the sale is also required. Where an asset plan has been approved, that approval delegates authority for sales to the assisted institution. Most agreements require or permit the institution to provide financing to facilitate the sale of a covered asset. Although loans to facilitate are generally limited by regulations, loans for the sale of a covered asset, where the loan thereafter becomes a covered asset pursuant to the assistance agreement, are not subject to such limitation.

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INDEMNIFICATION AND REIMBURSEMENTS OF LOSS AND EXPENSE

The assistance agreements generally provide that FSLIC will reimburse the acquirers for amounts actually incurred and paid in connection with the satisfaction, settlement or compromise of unreserved-for claims, challenges to the transaction, unassumed or undisclosed liabilities, non-existent assets or other types of claims, and for the reasonable costs and expenses related to such claims. The acquirer is required to use its best efforts to reduce or minimize indemnified claims by pursuit of related claims (e.g., counterclaims). Provided FSLIC approves the related claims, the reasonable costs and expenses incurred in pursuing such claims are also subject to FSLIC indemnification.

In addition to specific indemnification provisions, agreements also provide protection against losses on covered assets resulting from claims and the expenses of defending or pursuing claims. This coverage is provided through the guaranteed yield calculation (legal fees reduce actual yield earned on specific covered assets) or the covered asset loss calculation (legal fees capitalized to increase book value of the covered asset). In these transactions, legal fees for non-litigation transactional work, such as loan work-outs, real estate purchases and sales, and other work related to covered assets, are also reimbursable.

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INTEREST DIFFERENTIAL

Similar to yield maintenance guarantees for non earning or low-earning assets, interest differential payments were made to reimburse acquirers for high-cost, fixed-rate liabilities. Normally associated with Federal Home Loan Bank Advances that could not be prepaid without incurring excessive prepayment penalties, FSLIC would pay the acquirer over time all or a part of the difference between the contractual rate on the liability and market rates for similar long-term, fixed-rate liabilities.

GOODWILL AMORTIZATION

In some agreements FSLIC agreed to reimburse acquirers for goodwill created through mark-to-market adjustments on non-covered assets required by Generally Accepted Accounting Principles. As goodwill is amortized (written off), FSLIC reimburses the acquirer, usually dollar for dollar, for the amounts so amortized. This provision was not common in the 1988-1989 FSLIC agreements. It was more common for purchase accounting adjustments to be reflected in adjusted balances on FSLIC notes issued to cover negative net worth.

WARRANTS, STOCK, NOTES AND PROFIT-SHARING

Assistance agreements sometimes included warrants that gave

FSLIC the right to acquire stock in the resulting institution at some time in the future. FSLIC could not own common stock, but it could sell these warrants if they become valuable. The warrants usually included provisions that allowed FSLIC to share in dividends declared by the resultant institution. In other transactions, FSLIC purchased preferred stock and subordinated notes which counted as regulatory capital at the time of the transaction.

In some other agreements, FSLIC negotiated for a share of the acquired thrift's profits, such as a share of dividends declared on all of the outstanding stock of the resulting entity, or a portion of the net income of the resulting entity.

INDIRECT FORMS OF ASSISTANCE

In virtually all of the 1988-1989 transactions, the acquirers received, in addition to direct FSLIC financial assistance, varying levels of indirect financial and non-financial assistance through (1) the FHLBB's granting of exceptions to standard regulations for savings and loans through the use of forbearances; and (2) the tax free nature of direct financial assistance through special provisions in the Internal Revenue Code. This indirect assistance was sometimes as important to the acquirers as direct FSLIC financial assistance.

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FORBEARANCES

Forbearances granted include capital forbearance, forbearance from supervisory action, existing regulatory violation forbearance, forbearance to pursue various activities, and accounting forbearance. Each forbearance type and the effect on acquirers is discussed below.

Capital forbearance allows an institution to operate below the savings and loan industry minimum capital requirements. Such forbearance was often thought necessary, since capital infusions required of acquirers were either insufficient to meet the minimum standards, or it was anticipated that the resulting institution could fall below minimum capital standards due to the problems of the acquired institution(s). The capital forbearance did not protect an entity from normal FSLIC or FHLBB actions if the institution were to become insolvent absent the forbearance. Many of the transactions required capital levels to increase over time, based on individually negotiated schedules, in order to continue to receive the benefit of the capital forbearance.

Forbearances relating to various existing regulatory violations at the time of the transaction were also granted. This type of forbearance relates to investment and other transactions of the acquired institution prior to acquisition. The FHLBB provided relief from actions against the resulting

institution due to violations of individual regulations, as long as the violations existed or the transactions causing the violation existed as of the acquisition date.

Another type of forbearance allowed acquirers to pursue various activities not normally permissible under savings and loan regulations. For example, certain forbearances permitted the acquirers to exceed the set growth rate or avoid dividend restrictions.

Forbearances regarding exceptions to accounting rules were granted as well. For transactions completed in the first half of 1988, some institutions were permitted to record the initially infused FSLIC promissory note as additional capital. Accounting forbearances relating to depreciation schedules and accounting for FSLIC assistance were also provided.

The forbearances granted vary depending on the type of acquirer, the problems facing the acquired institutions and the acquirer's business plan.

FIRREA

The enactment of FIRREA established new standards for minimum regulatory capital levels including core, tangible and risk based capital. In January of 1990, the Office of Thrift

Supervision (OTS) advised all savings associations that FIRREA had eliminated capital and capital-related accounting forbearances previously granted by the FHLBB and the FSLIC and that any institutions presently operating under such forbearance agreements should eliminate them in determining compliance with the new minimum regulatory capital standards. As a result, there have been several legal actions initiated which challenge the authority of the OTS to modify or terminate existing agreements, particularly since FIRREA provides that no actions should be taken that abrogate the contracts. As these cases are still in various stages of litigation or appeal, the ultimate effect and enforceability of the capital forbearances remains uncertain.

CAPITAL STATUS

Notwithstanding the original capital agreements, through a combination of capital infusions and retention of income, only a small handful of the acquirers in the transactions reviewed (excluding the 12 institutions under the control of RTC and FDIC) do not appear to be in compliance with the FIRREA established capital requirements.

In those transactions which failed the FIRREA capital standards, the primary reason was the inclusion of 100 percent of the government guaranteed notes and covered assets in the core and tangible capital calculations. As the FSLIC covered assets

are correctly placed in the 0% risk category, most resulting entities pass the risk based capital standard by a large margin.

At the present time OTS has provided an avenue for relief for institutions failing the capital requirements through capital plans which are required from all institutions which fail any of the three FIRREA capital requirements, and which must be approved by OTS.

GENERAL TAX ISSUES IN ASSISTED ACQUISITIONS

Although not all acquirers requested a private letter ruling from the Internal Revenue Service, given the changes in the tax law enacted as part of the Economic Recovery Tax Act of 1981, acquisitions of troubled institutions in 1988 and 1989 are most often treated as tax-free acquisitions, pursuant to Sections 368(a)(1)(G) and 368 (a)(3)(D)(ii) of the Internal Revenue Code of 1986, with the retention of tax attributes of the acquired institution and the relaxation of limitations on loss carryovers. In addition, payments received from FSLIC are generally treated as tax-free. These items are discussed in detail below:

TAX-FREE ACQUISITION

The 1981 tax legislation relaxed rules for determining whether an acquisition met certain statutorily imposed

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requirements for characterization as a tax-free reorganization. Specifically, Internal Revenue Code ("IRC") Section 382(l)(5)(F) provided that depositors of the acquired institution could be considered as owners in determining whether the old owners of the acquired institution had retained a meaningful interest in the new entity; that is, the depositors of the acquired entity whose deposits were assumed by the acquirer were deemed to retain an ownership interest, for this limited purpose, in the new entity. This provision often assured acquirers compliance with the so-called "continuity of interest" test. In the absence of such a provision, the test would have been satisfied only if the shareholders of the acquired entity continued to own some significant portion of the new entity. Because an acquirer generally acquired all of the stock (eliminating historic shareholders of the acquired entity), the continuity of interest requirement would not otherwise have been met.

Because the acquisition is tax-free, neither the depositors, nor the acquired institution, nor the acquirer recognizes gain or loss on the transaction. For tax purposes, it is as though the acquired entity continues in existence with different shareholders. For tax purposes, assets and liabilities continue to be carried at the historic bases. Tax attributes such as net operating losses, capital loss carryovers and tax credit carryovers survive the acquisition, although they are subject to the limitations of the Treasury regulations which govern

consolidated returns.

SURVIVAL OF TAX ATTRIBUTES

Treating the acquisition as tax-free allows for the survival of tax attributes that otherwise would have been lost, recaptured, or subject to strict limitation. Some of the more significant attributes are discussed below.

NET OPERATING LOSSES

Losses recognized by the acquired entity before the acquisition can be carried over to years after the acquisition for use in sheltering income of the acquirer. These losses are subject however, to separate return limitation year rules ("SRLY") prescribed by the consolidated return regulations. The SRLY rules limit the use of the net operating losses of the acquired institution against income of other members in the acquirer's consolidated group. Effectively, these SRLY losses can only be used to offset income of the acquired institution after the acquisition. A common strategy of acquirers after the acquisition is to transfer assets to the acquired entity or to merge it with another profitable business to enable the acquired entity to generate its own taxable income which can absorb the SRLY losses. The carry-forward period for net operating losses of thrifts is varied, depending upon the year in which the loss

was generated.

TAX BASIS OF ASSETS AND LIABILITIES

Most of the troubled entities have assets which have depreciated substantially over the years. That is, the fair market value of the assets is substantially lower than the tax basis of such assets. This depreciation has not resulted in significant tax savings because the assets have not been sold, but have merely declined in value. Such decline in value generally does not result in an immediate tax deduction. As a result there are substantial deductions inherent in the assets acquired. These deductions are known as "built-in" deductions. The acquirer can trigger the recognition of these built-in deductions in a number of ways and thus offset income of it or other members of its consolidated group. Built-in deductions are generally not subject to SRLY-type limitations and may be used without limit by the acquirer to shelter its income and the income of other members of its consolidated group.

TAX-EXEMPT FSLIC ASSISTANCE PAYMENTS

For acquisitions occurring before January 1, 1989, IRC Section 597 provided that payments received by an acquired institution or an acquirer of such institution from FSLIC pursuant to Section 406(f) of the National Housing Act were

permitted to be received tax-free. For acquisitions occurring after December 31, 1988 and before May 10, 1989, 50 percent of payments received are effectively subject to tax, through a reduction of acquired net operating losses, interest expense deductions and built-in deductions. Payments include the following:

- Net worth notes or cash: Both the cash, and the notes and the interest thereon are tax exempt.

- Loss coverage/loss guarantees: Effectively, these payments eliminated or substantially reduced the risk of economic loss by the acquirer on the acquisition of the troubled assets. However, because the assistance was tax-free, the tax benefit of the built-in losses is generally assumed to be retained for tax purposes. As a result, an acquirer is compensated, tax free, for the loss in value in the assets, and still retains a tax deduction for such depreciation. As discussed in Chapter IV and Appendix V, it is not entirely clear whether the acquirers are able to retain the tax deduction on covered assets when assistance is paid to reimburse the acquirer for its economic loss.

- Yield maintenance payments: These yield maintenance payments are tax exempt.

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- Expense reimbursement/indemnification payments: Many of the acquisition agreements provided for indemnification of the acquirers against losses and claims resulting from actions or inactions of the former management. Such reimbursements provided tax benefits in the same manner as loss coverage/guarantee arrangements discussed above.

ASPECTS OF TAX SHARING ARRANGEMENTS

The terms of the assisted acquisitions of the troubled thrifts are generally set forth in the assistance agreement. These agreements usually contain a tax section which defines tax benefits and specifies the amounts, if any, to be shared with FSLIC by the acquirer. There are two basic methods of tax sharing arrangements with FSLIC; in certain acquisitions the two methods were combined or there were no provisions for tax sharing. As the definition of tax benefits and the sharing ratios were a part of the deal negotiations, there was a great variety in the types of specified tax benefits and the percentage of sharing thereon.

The two basic methods of tax sharing are the "with-and-without" approach, and the "after-tax" approach.

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WITH-AND-WITHOUT APPROACH

This method provides sharing with FSLIC the reduction in taxable income or tax liability which results from the tax-free nature of FSLIC assistance payments, the deduction of the acquired net operating losses, built-in deductions, and other defined tax benefit items. The individual agreements generally define which tax benefits are to be considered and the amount of benefit to be shared with FSLIC, ranging from 0 to 100 percent. The many variations of the with and without method included differences in percentage of sharing and type of benefits subject to sharing, the timing of the payment to FSLIC for the specified tax benefits (i.e., upon actual usage or upon generation of the benefit), and fluctuations in the percentage or type of benefits shared based upon, e.g., some aggregate benefit received or some target rate of return to the acquirer.

AFTER-TAX APPROACH

This method provides that assistance payments will be made to the acquirer net of a specified percentage of the tax benefit thereon. The tax benefit thereon is generally calculated at some agreed upon tax rate, or may be defined on the basis of the current corporate tax rates then in effect. Many variations exist with regard to the types of benefits subject to the sharing formula and the percentage to be shared with FSLIC.

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TYPES OF TAXES COVERED

Assistance agreements may specify that taxes other than federal income tax are covered by the terms of those agreements. State taxes, alternative minimum taxes, foreign taxes, and other taxes may be subject to sharing or reimbursement type provisions.

CATEGORIES OF TRANSACTIONS

During the period from January 1, 1988, to August 9, 1989, FSLIC entered into 96 assistance agreements with 91 resulting institutions. Each of the now 90 resultant institutions (two merged into one) and the 194 acquired failed or failing institutions resolved are identified in chronological order based on the date of the assisted transaction in Appendix I to this report. In Appendix II to this report, the 96 transactions are listed by the states in which the resulting institution is domiciled.[3]

For purposes of this review, the assistance agreements have been separated into five categories according to their degree of complexity or the government's ability to effectuate changes unilaterally. The categories are cash transactions, small

[3]In a small number of transactions, more than one institution resulted. These multiple institution transactions are identified in Appendix I.

transactions, large transactions, mega transactions, and transactions with institutions which remain, or are now under government control. This categorization is useful in segmenting the transactions both by their complexity and by their exposure.

"Cash Transactions" are deals in which cash payments were made and the only continuing government obligation is usually to reimburse for legal expenses resulting from unreserved claims against the acquired institution. There is no material ongoing exposure to the FRF in these cases as all assistance has essentially been paid. The transactions and the forms of assistance granted are identified in Table 1.

"Small Transactions" are those in which notes and covered assets are minimal (under $50 million), and where for a small outlay (not including note balances), the government could likely terminate the agreement (except, possibly for limited legal indemnification) without having a major adverse impact on the acquirer. The transactions and the forms of assistance granted are identified in Table 2.

"Large Transactions" are those where significant covered assets (between $50 and $500 million) and FSLIC notes remain. In a number of these transactions the covered assets and the notes are not so large that a unilateral exercise of buy-out options

under the contract or a negotiated phasing out of the assistance agreement over shorter time periods than originally agreed upon could be possible for both the government and the acquirer to absorb if properly structured. Transactions that meet this definition along with the forms of assistance granted are included in Table 3.

"Mega Transactions" are those in which the amount of covered assets (over $500 million) and other obligations will make it difficult for the acquirer to easily accept any major changes in the assistance terms. Any changes to these agreements will involve significant renegotiations. However, absent any successful renegotiation, the government could exercise a number of its unilateral rights to reduce costs. The 13 transactions meeting RTC's definition of a mega transaction and the assistance granted are included in Table 4.

"Government Institutions" are those in which assistance was provided to an institution which remains or is now under government control and can be restructured as the government deems appropriate. If these institutions were not under government control, they would have been included in the small, large and mega categories defined above. These transactions include stabilizations[4] as well as those cases where a

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[4]In a stabilization, the resultant thrift is a federally chartered mutual savings and loan association. Under the terms of the assistance agreement, FSLIC retained control and can dictate a

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subsequent RTC conservatorship and receivership has occurred at either the thrift or parent thrift level. The institutions that are effectively controlled by the RTC and the FDIC are listed in Table 5 along with the types of assistance still being paid by FRF.

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subsequent reorganization to permanently resolve the institution.

Table 1
Forms of Assistance
Cash Transactions

FDIC Case No.	Institution Name	Cash	Notes	Yield Maintenance	Loss Coverage	Gain Sharing	Tax/ Profit Sharing	Capital Instruments	-Forbearance- Capital	Other
1726	Lemont SA	X							X	X
1727	Home FS&LA, TN	X					X			
1731	SaveTrust FSB	X					X		X	X
1732	Ameribank FSB	X					X		X	X
1736/1747	United Savings of America	X					X		X	X
1740	First FS&LA of Lincoln/IA	X							X	
1742	Washington FS&LA	X					X			
1743	Old Stone Bank of CA	X					X		X	X
1745	Citizens FSB	X					X		X	X
1748	Secor Bank, FSB	X					X			
1755	First Federal Bank, FSB	X					X		X	X
1757	Tracy S&LA, FA	X					X		X	X
1758	First FSB of Indiana	X					X		X	X
1759	Republic SB, FSB	X					X		X	X
1760	New Peoples FSB	X					X		X	
1761	Crossland Savings Bank, FSB	X					X		X	X
1765	MidAmerica SB, FSB	X							X	X
1766	First Western FSA	X					X		X	
1768	First FS&LA of Lincoln	X							X	X
1773	Virginia FSB	X							X	X
1776	Barnett Bank of SW Georgia	X					X			
1784	Southeast Bank, NA	X					X			
1791	Home FS&LA, SD	X					X		X	
1793	First Florida SB, FSB	X					X		X	X

Table 2

Forms of Assistance

Small Transactions

FDIC Case No.	Institution Name	Cash	Notes	Yield Maintenance	Loss Coverage	Gain Sharing	Tax/ Profit Sharing	Capital Instruments	-Forbearances- Capital	Other
1721/1751	Homebanc FSB	X		X	X		X			
1725	Sterling Savings Assn	X		X	X		X		X	X
1728	Hansen SB, S&LA	X			X				X	X
1734	World S&LA of America	X				X	X		X	
1735	River Valley SB, FSB	X			X	X	X	X	X	
1736	River Valley SB	X			X		X		X	
1737	First FSB Northwest	X		X					X	X
1739	Standard FB, FSB	X	X		X	X	X		X	
1744	Security Trust FS&LA	X		X	X		X		X	X
1746	First FSB	X		X	X	X	X		X	X
1749	Washington FS&LA		X				X			
1752/1753	Union FSB of IN	X		X	X		X		X	X
1756	Amerlana SB, FSB	X			X	X	X		X	X
1763	Flagship FSB	X			X	X	X	X	X	X
1764	Southside SB, FSB	X			X		X		X	X
1769	World S&LA of Ohio	X				X			X	X
1770	First Nationwide Bank FSB		X				X		X	X
1771	Citibank FSB	X			X	X				
1777	Citizens FB, FSB	X	X	X	X	X	X		X	X
1779	Northwest FSB		X	X	X	X	X		X	X
1781	Metropolitan FB of IA		X	X	X	X	X		X	X
1782	Western FSB MT	X			X	X	X		X	
1786	River Valley, SB FSB	X	X				X		X	
1792	First Cook BK for Savings	X	X	X	X				X	

Table 3
Forms of Assistance
Large Transactions

FDIC Case No.	Institution Name	Cash	Notes	Yield Maintenance	Loss Coverage	Gain Sharing	Tax/ Profit Sharing	Capital Instruments	- Forbearances- Capital	Other
1729/1733	Eureka Bank, FSB	X		X	X		X	X	X	X
1741	Metropolitan FB of IA/MN		X	X	X	X	X		X	X
1750	Western FS&LA		X	X	X	X		X	X	X
1754	Downey S&LA		X	X	X	X	X		X	X
1762	First Nationwide Bank FSB	X	X		X	X	X		X	X
1767	Pacific First Bank	X	X	X	X	X	X		X	X
1772	NVR SB, FSB	X		X	X	X	X		X	X
1774	Rocky Mountain FSB		X	X	X	X	X			X
1778	Jackson County FS&LA	X		X	X	X	X	X	X	X
1783	Home FS&LA		X	X	X		X		X	X
1785	Beach FS&LA		X				X		X	X
1789	Calif. FB- Broward, FSB		X	X	X	X	X		X	X
1794	Coastal Banc SA		X	X	X	X	X	X	X	X
1809	Americity FSB	X	X	X	X	X	X	X	X	X
1813	Texas Trust SB, FSB		X	X	X	X	X	X	X	X
1814	Local America BK of Tulsa		X	X	X		X	X	X	X
1816	Equity Bank for Savings		X	X	X	X				

Table 4
Forms of Assistance
Mega Transactions

FDIC Case No.	Institution Name	Cash	Notes	Yield Maintenance	Loss Coverage	Gain Sharing	Tax/ Profit Sharing	Capital Instruments	- Forbearances- Capital	Other
1776	New West		X	X	X	X	X	X	X	X
1780	First Nationwide Financial Corp.		X	X	X	X	X		X	X
1786	Superior Bank, FSB	X	X	X	X				X	X
1790	Beverly Hills FSB		X	X	X	X	X		X	X
1797	American Federal Bank, FSB		X	X	X	X	X	X	X	X
1804/1805	First Heights Bank, FSB		X	X	X		X	X	X	X
1806	Guaranty FSB		X	X	X	X	X	X	X	X
1807	Franklin Federal Bancorp, FSB		X	X	X	X	X	X	X	X
1808	Amwest SA		X	X	X	X	X	X	X	X
1810	Bluebonnet SB, FSB		X	X	X	X	X	X	X	X
1811	First Gibraltar Bank FSB		X	X	X	X	X	X	X	X
1812	Pacific Southwest Bank FSB		X	X	X	X	X	X	X	X
1815	United SA of Texas, FSB		X	X	X	X	X	X	X	X

Table 5
Forms of Assistance
Under Gov't Control Transactions

FDIC Case No.	Institution Name	Cash	Notes	Yield Maintenance	Loss Coverage	Gain Sharing	Tax/ Profit Sharing	Capital Instruments	- Forbearances- Capital	Other
1722	Atlantic Financial Fed-WVA	X	X	X	X	X	X	X	X	X
1723	Great West SB FSB	X	X				X		X	X
1724	Statesman BK for Savings FSB	X	X	X	X	X	X		X	X
1730	First Fed SB of Hempstead	X		X	X	X	X		X	X
1787	First Network Savings Bank		X	X	X	X	X		X	X
1795	Southwest Savings Assn		X	X	X	X	X	X	X	X
1798/1799	Merabank Texas FSB		X	X	X	X	X	X	X	X
1798	Sunbelt Savings, FSB		X	X	X		X			X
1800	Cimarron FS&LA		X	X	X		X			
1801	Red River FS&LA		X	X	X		X			
1802	Chisholm FS&LA		X	X	X		X			
1803	Heartland FS&LA		X	X	X		X			

ESTIMATED COSTS OF THE ASSISTANCE AGREEMENTS

COMPONENTS OF COST

Costs, for purposes of this review, are defined as costs related to the assistance agreement paid from, less payments to, the FRF. The agreements however, also include additional costs to the government, primarily tax revenue losses to the Treasury due to the deductibility of various tax items in acquirer and parent company tax returns.

The costs of FSLIC Assistance Agreements to the FRF are comprised of the following major components:

COSTS INHERENT IN THE ACQUIRED INSTITUTIONS:

- Promissory notes or cash infused by FSLIC to offset the amount of negative net worth of the savings and loan association at the effective date of the assistance agreement.

- Capital loss protection to the extent that proceeds upon disposition are less than the book value of the covered assets.

CARRYING COSTS:

- Interest payments on the promissory notes at rates stipulated in the agreements.

- Guaranteed yield maintenance payments provided on the covered assets at rates stipulated in the agreements.

OTHER COSTS AND RECOVERIES[5]:

- Other payments related to gain sharing, litigation or other matters offset by tax sharing arrangements, profit sharing and equity interests.

In addition to FRF costs shown above, the acquirers often received tax benefits in the form of tax loss carry-forward deductions and tax losses from current operations which, in many cases can be utilized to offset other taxable income of the parent organization. These tax benefits, to the extent that they are utilized by acquirers to offset otherwise taxable income

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[5]For purposes of this review neither RTC nor its contractors attempted to verify or estimate the likely recovery on assets acquired by FSLIC in its corporate or receivership capacities prior to or subsequent to the effective date of the assistance agreements. According to information provided by FDIC, assets were purchased in nine of the 96 transactions. As of December 31, 1989, FDIC estimates the recovery on these assets to be $1.05 billion. The underlying assets on which the recovery is based are usually managed by the acquiring institution pursuant to separate contractual agreements.

represent tax revenue losses to the Treasury, which may be partially offset by provisions requiring the acquirer to share such tax benefits with FRF.

The amount of such tax attributes available for utilization is likely to be in excess of $5.0 billion of tax loss carry-forwards, and may be as much as $13.5 billion of built-in losses. If all of the tax attributes could be utilized against otherwise taxable income, the revenue loss to the U.S. Treasury would be substantial. However, due to uncertainties related to the amount of such benefits which might be utilized by acquirers, including the lack of tax return information available to the RTC, the tax revenue loss to the Treasury is not yet susceptible to reasonable estimation. Therefore, neither RTC nor its contractors attempted to estimate the cost of the assistance agreements including tax revenues forgone by the U.S. Treasury. Additionally, it is important to bear in mind that the government effectively owns 12 institutions that account for 30 percent of estimated future assistance payments.

While estimates of the overall cost to the U.S. Government as a whole, including tax revenues foregone, is beyond the scope of this report, the cost estimates of the assistance agreements to the FRF do include estimates of tax sharing payments due the FRF where information was made available by the acquirers. While these numbers are significant when viewed in isolation, they

usually make up for less than five percent of the costs likely to be incurred by the FRF. Additionally, as discussed in Chapter IV, each of the contractors and this report attempts to take into consideration the tax consequences of individual and overall cost savings options.

COSTING UNCERTAINTIES

The most significant assumptions in the costing process which have major degrees of uncertainty relate to estimates of disposition timing and fair market value (estimated realizable value) of covered assets. Generally, the agreements provided for 100% reimbursement of losses on covered assets when liquidated. The nature of the assets is such that, at this juncture, while estimates exist for the fair market value, there is a degree of uncertainty in such estimates and they are subject to the impact of future events which are not possible to fully predict. Likewise, the period of time estimated to dispose of those assets is imprecise and subject to significant uncertainty. These variables impact the level of two major costs components, estimated capital loss and yield maintenance costs for the transactions.

Interest rate assumptions were also necessary in the modeling process. The interest rate scenarios generally assumed constant interest at rates that approximate current rates. To

the extent that interest rates vary from that scenario those costs will vary. The interest rate scenarios used, along with all costing assumptions, are discussed in Appendix III to this report.

The remaining costs (note principal amounts, litigation, and other costs) are generally fixed, relatively speaking, more easily estimated.

COST SUMMARIES

The six tables that follow summarize the results of RTC's cost estimating process. The tables include the same categories of institutions used in the prior section of this chapter.

Table 6
Estimates of Assistance Payments
Cash Transactions
(In $ Millions)

FDIC Case No.	Institution Name	FRF Payments: Cash	Note Principal	Note Interest	Yield Maint	Capital Losses	Other Payments	FRF Receipts: (Tax Sharing)	(Other Receipts)	Net Total	Totals: Prior to 1/1/90	After 12/31/89	After 12/31/89 (PV)
1726	Lemont SA	6.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.1	6.1	0.0	0.0
1727	Home FS&LA, TN	7.1	0.0	0.0	0.0	0.0	0.2	0.0	(0.0)	7.3	7.2	0.2	0.2
1731	SaveTrust FSB	11.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.0	11.0	0.0	0.0
1732	Amerlbank FSB	4.0	0.0	0.0	0.0	0.0	0.0	(2.3)	0.0	1.7	4.0	(2.3)	(1.8)
1736 /1747	United Savings of America	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1740	First FS&LA of Lincoln, IA	20.1	0.0	0.0	0.0	0.0	0.0	(1.0)	(5.3)	13.8	13.8	0.0	0.0
1742	Washington FS&LA	2.4	0.0	0.0	0.0	0.0	0.2	0.0	0.0	2.6	2.4	0.1	0.1
1743	Old Stone Bank of CA	44.9	0.0	0.0	0.0	0.0	1.0	0.0	0.0	45.9	45.1	0.8	0.7
1745	Citizens FB, FSB	0.0	0.0	0.0	0.0	0.0	0.5	0.0	0.0	0.5	0.0	0.4	0.4
1748	Secor Bank, FSB	13.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	13.0	13.0	0.0	0.0
1755	First Federal Bank, FSB, IN	9.5	0.0	0.0	0.0	0.0	0.5	(1.0)	0.0	9.0	9.0	0.0	0.0
1757	Tracy S&LA, FA	3.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	3.2	3.1	0.1	0.1
1758	First FSB of Indiana	29.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	29.0	29.0	0.0	0.0
1759	Republic SB, FSB	25.9	0.0	0.0	0.0	0.0	0.1	0.0	0.0	26.0	26.0	0.0	0.0
1760	New Peoples FSB	34.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	34.9	34.9	0.0	0.0
1761	Crossland Savings Bank, FSB	11.3	0.0	0.0	0.0	0.0	0.2	0.0	0.0	11.5	11.3	0.2	0.2
1765	MidAmerica SB, FSB	14.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	14.0	14.0	0.0	0.0
1766	First Western FSA	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.0	2.0	0.0	0.0
1768	First FS&LA of Lincoln, NE	21.5	0.0	0.0	0.0	0.0	0.0	(0.3)	(2.0)	19.2	19.2	0.0	0.0
1773	Virginia FSB	13.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	13.5	13.5	0.0	0.0
1775	Barnett Bank of SW Georgia	4.9	0.0	0.0	0.0	0.0	0.1	0.0	0.0	5.0	4.9	0.0	0.0
1784	Southeast Bank, NA	29.0	0.0	0.0	0.0	0.0	1.0	0.0	0.0	30.0	29.0	1.0	1.0
1791	Home FS&LA, SC	8.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	8.1	8.0	0.1	0.1
1793	First Florida SB, FSB	11.0	0.0	0.0	0.0	0.0	1.0	0.0	0.0	12.0	11.0	1.0	1.0
	Total	332.1	0.0	0.0	0.0	0.0	5.0	(4.6)	(7.3)	326.2	324.1	1.7	2.3

Table 7
Estimates of Assistance Payments
Small Transactions

(In $ Millions)

FDIC Case No.	Institution Name	FRF Payments: Cash	Note Principal	Note Interest	Yield Maint	Capital Losses	Other Payments	FRF Receipts: (Tax Sharing)	(Other Receipts)	Net Total	Totals: Prior to 1/1/90	After 12/31/89	After 12/31/89 (PV)
1721 /1761	Homebane FSB	16.0	0.0	0.0	1.8	2.0	0.0	0.0	0.0	19.8	19.8	0.0	0.0
1725	Sterling Savings Assn	11.2	0.0	0.0	1.7	2.1	0.7	(0.8)	0.0	14.9	12.9	2.0	1.8
1726	Hanson SB, S&LA	61.9	0.0	0.0	0.0	17.1	1.8	0.0	(0.9)	80.8	76.8	4.7	4.0
1734	World S&LA of America	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.2	0.1	0.1	0.1
1735	River Valley, Peoria	36.0	0.0	0.0	0.0	2.8	1.8	0.0	(1.9)	38.8	37.7	0.8	0.8
1736	River Valley SB, Rock Falls	17.8	0.0	0.0	0.0	1.7	0.0	0.0	0.0	19.2	17.8	1.7	1.8
1737	First FSB Northwest	11.8	0.0	0.0	0.0	0.0	7.1	0.0	(8.4)	10.2	18.8	(8.4)	(2.8)
1738	Standard FS FSB	13.8	18.2	10.8	0.0	0.0	0.0	0.0	0.0	42.8	14.3	28.2	22.8
1744	Security Trust FS&LA	18.8	0.0	0.0	1.4	0.4	0.4	(0.1)	0.0	20.7	19.4	1.8	1.2
1746	First FSB, Rogers AR	22.8	0.0	0.0	1.8	2.7	0.4	(3.4)	(0.8)	23.1	22.4	0.7	1.8
1748	Washington FS&LA	0.0	31.0	31.8	0.0	0.0	0.8	(0.9)	0.0	64.4	2.8	80.8	30.8
1752 /1753	Union FSB of IN	31.0	0.0	0.0	5.1	0.8	0.8	(2.1)	0.0	40.9	34.8	6.0	5.7
1756	Amerlana SB, FSB	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1763	Flagship FSB	25.8	0.0	0.0	0.0	0.3	0.1	0.0	0.0	25.8	25.8	0.3	0.3
1764	Southside SB, FSB	10.0	0.0	0.0	0.0	1.0	0.0	0.0	0.0	11.0	11.0	0.0	0.0
1766	World S&LA of Ohio	90.8	0.0	0.0	0.0	0.0	0.7	(6.1)	0.0	86.2	84.6	0.7	0.0
1770	First Nationwide Bank FSB	0.0	174.8	99.8	0.0	0.0	1.8	0.0	0.0	276.8	0.3	266.5	147.8
1771	Citibank FSB	16.4	0.0	0.0	0.0	0.0	2.6	0.0	0.0	19.8	14.8	4.8	4.1
1777	Citizens FS, FSB	106.0	25.8	17.0	3.8	0.0	11.8	(1.8)	0.0	172.0	111.8	61.8	46.8
1778	Northwest FSB	0.0	80.4	81.2	6.1	1.8	0.0	(1.8)	0.0	114.8	6.8	108.8	88.3
1781	Metropolitan FS of Iowa	0.0	80.3	40.3	10.8	10.8	0.4	0.0	0.0	136.8	0.2	126.8	79.8
1782	Western FSB MT	11.8	0.0	0.0	0.0	0.4	0.0	(2.3)	0.0	9.1	11.8	(1.8)	(1.4)
1788	River Valley SB FSB	3.3	13.2	13.7	0.0	0.0	0.0	0.0	0.0	30.2	4.4	25.8	18.2
1793	First Cook BK for Savings	18.1	50.1	0.6	0.2	2.8	2.4	0.0	(0.3)	78.8	76.7	2.0	2.4
	Total	533.3	436.1	274.2	29.9	66.4	31.8	(27.5)	(11.2)	1,336.8	848.9	666.8	429.8

Table 8
Estimates of Assistance Payments
Large Transactions
(In $ Millions)

FDIC Case No.	Institution Name	FRF Payments: Cash	Note Principal	Note Interest	Yield Maint	Capital Losses	Other Payments	FRF Receipts: (Tax Sharing)	(Other Receipts)	Net Total	Totals: Prior to 1/1/90	After 12/31/89	After 12/31/89 (PV)
1729 /1733	Eureka	394.0	0.0	0.0	47.0	31.0	(1.0)	0.0	(54.0)	417.0	403.0	14.0	32.0
1741	Metropolitin FB of IA/MN	0.0	306.1	267.4	87.9	69.2	2.0	0.0	0.0	734.6	62.0	672.6	426.3
1760	Western FS&LA	0.0	575.8	178.0	80.2	6.3	10.3	0.0	(16.3)	834.1	187.3	646.8	558.4
1764	Downey S&LA	0.0	259.4	124.3	13.8	36.9	12.5	(17.9)	0.0	431.0	28.6	402.4	316.2
1762	First Nationwide Bank FSB	40.2	116.0	28.7	0.0	0.0	1.8	0.0	(0.7)	186.0	64.6	120.4	103.2
1767	Pacific First Bank	20.8	83.4	37.1	26.8	47.2	4.8	(1.8)	0.0	220.8	48.0	172.8	136.3
1772	NVR SB, FSB	48.0	0.0	0.0	13.0	27.0	3.0	(7.0)	(10.0)	74.0	62.0	12.0	12.0
1774	Rocky Mountain FSB	0.0	117.3	63.8	36.5	20.7	1.9	(3.8)	(0.8)	224.7	16.8	208.0	166.2
1778	Jackson County FS&LA	28.0	0.0	0.0	0.9	30.3	2.0	(1.8)	(0.1)	68.8	31.8	37.0	33.8
1783	Home FS&LA	0.0	253.4	99.8	4.4	(1.3)	2.3	(9.4)	0.8	349.2	16.8	332.7	268.8
1785	Beach FS&LA	0.0	1,081.8	527.0	0.0	0.0	0.0	(1.0)	(16.0)	1,671.8	84.0	1,487.8	1,124.0
1788	Calif. FB- Broward, FSB	0.0	113.0	95.8	17.2	58.9	2.9	0.0	(1.8)	286.3	24.6	261.7	173.8
1794	Coastal Banc, SA	0.0	42.8	44.0	153.0	128.0	43.0	(12.0)	(16.0)	381.8	68.8	313.8	218.0
1809	Amerlolty FSB	0.0	30.8	27.0	218.0	208.8	11.0	(18.0)	(2.0)	474.0	22.0	452.0	292.0
1813	Texas Trust SB, FSB	0.0	190.0	158.5	196.2	181.8	51.8	(78.2)	(8.8)	881.1	88.5	882.8	466.8
1814	Local America BK of Tulsa	0.0	40.8	19.8	42.0	44.8	23.8	0.0	(2.2)	188.8	16.2	152.8	123.4
1818	Equity Bank for Savings	0.0	48.4	34.7	15.8	26.4	38.2	(12.2)	(2.0)	141.1	8.9	134.2	82.8
	Total	531.0	3,229.1	1,886.8	980.8	983.1	208.8	(188.8)	(127.8)	7,231.1	1,208.8	6,021.8	4,471.1

Table 9
Estimates of Assistance Payments
Mega Transactions

(In $ Millions)

FDIC Case No.	Institution Name	FRF Payments: Cash	Note Principal	Note Interest	Yield Maint	Capital Losses	Other Payments	FRF Receipts: (Tax Sharing)	(Other Receipts)	Net Total	Totals: Prior to 1/1/90	After 12/31/89	After 12/31/89 (PV)
1778	New West	0.0	448.0	125.5	6,783.8	2,467.1	295.9	(614.3)	(800.0)	7,856.1	(0.6)	7,856.1	3,949.7
1780	First Nationwide Fin'l Corp.	0.0	1,767.2	1,194.7	770.6	429.9	433.9	(173.4)	(167.7)	4,256.3	513.8	3,741.6	2,297.2
1786	Superior FSB	33.4	227.1	116.0	142.7	34.2	4.0	(22.6)	0.0	535.4	58.8	476.6	364.7
1790	Beverly Hills FSB	0.0	806.6	610.3	119.2	247.8	89.0	(166.6)	0.0	1,906.9	109.8	1,797.1	1,172.7
1797	American FS, FSB	0.0	536.0	511.2	531.1	519.9	220.9	0.0	(11.1)	2,907.0	293.5	2,613.5	1,991.5
1804 /1805	First Heights Bank, FSB	0.0	346.9	336.2	376.9	662.8	240.3	(50.6)	(25.1)	1,788.5	192.6	1,595.9	1,181.1
1806	Guaranty FSB	0.0	1,004.0	1,062.9	1,023.0	636.0	251.0	(250.6)	(27.0)	3,811.0	248.0	3,563.0	2,344.0
1807	Franklin Federal Bancorp	0.0	479.0	406.0	336.0	528.0	30.0	(31.6)	(21.0)	1,735.0	172.0	1,563.0	1,147.0
1808	Amwest SA	0.0	432.8	367.7	1,311.6	663.0	166.2	(166.2)	(21.6)	2,966.4	210.8	2,476.6	1,662.6
1810	Bluebonnet SB, FSB	0.0	780.0	650.0	766.0	736.0	295.0	(24.0)	(28.3)	3,166.7	190.7	3,016.0	2,078.0
1811	First Gibraltar Bank, FSB	0.0	3,195.0	2,825.0	1,535.0	1,166.0	82.0	0.0	(178.0)	8,717.0	446.0	8,271.0	6,250.0
1812	Pacific Southwest Bank FSB	0.0	313.6	263.0	271.0	263.7	98.0	(56.3)	(13.6)	1,129.0	97.4	1,031.6	691.6
1815	United SA of Texas FSB	0.0	306.0	277.7	488.3	328.7	210.2	(117.3)	(73.7)	1,421.5	366.0	1,066.5	766.3
	Total	33.4	10,708.8	9,096.3	13,729.9	9,779.1	2,414.6	(1,663.9)	(1,166.4)	41,914.9	2,886.6	39,667.7	24,916.2

Table 10
Estimates of Assistance Payments
Under Gov't Control Transactions
(In $ Millions)

FDIC Case No.	Institution Name	FRF Payments: Cash	Note Principal	Note Interest	Yield Maint	Capital Losses	Other Payments	FRF Receipts: (Tax Sharing)	(Other Receipts)	Net Total	Totals: Prior to 1/1/90	After 12/31/89	After 12/31/89 (PV)
1722	Atlantic Financial Fed--WVA	46.0	86.0	71.6	10.6	4.1	51.3	(8.1)	(141.5)	118.6	101.6	17.0	13.7
1723	Great West SB FSB	3.0	1.2	1.9	0.0	0.0	0.6	0.0	(3.7)	3.2	4.0	(0.8)	(0.8)
1724	Statesmen BK for Savings, FS	0.0	84.6	12.0	37.7	44.0	78.6	0.0	(0.2)	226.6	111.0	115.6	102.6
1730	First Fed SB of Hempstead	7.6	0.0	0.0	0.7	1.6	0.1	0.0	0.0	9.8	7.8	2.0	1.8
1787	First Network Savings Bank	0.0	32.6	32.4	1.3	0.7	0.3	0.0	(1.8)	65.6	2.0	63.7	37.5
1796	Southwest Savings Assn	0.0	813.0	704.6	1,271.4	1,715.8	144.3	0.0	(81.0)	4,598.0	544.0	4,054.0	2,888.0
1798 /1799	Mersbank Texas FSB	0.0	617.0	628.0	150.0	110.3	56.3	(4.6)	(21.4)	1,541.7	125.9	1,417.4	990.0
1798	Sunbelt Savings, FSB	0.0	3,510.4	3,265.9	1,038.6	2,283.8	314.9	0.0	(28.4)	11,293.2	894.8	10,398.3	6,901.8
1800	Cimarron FS&LA	0.0	93.8	3.7	62.9	78.4	47.9	(12.1)	(4.2)	270.6	114.4	156.8	126.8
1801	Red River FS&LA	0.0	86.0	14.8	58.1	89.1	58.4	(6.3)	(0.8)	295.3	48.0	219.2	173.4
1802	Chisolm FS&LA	0.0	37.6	19.9	14.6	18.7	10.9	(2.7)	(2.1)	96.7	20.6	76.3	64.7
1803	Heartland FS&LA	0.0	140.9	8.2	116.6	66.1	62.4	(57.3)	(14.1)	320.8	161.4	159.4	137.3
	Total	56.6	5,439.6	4,762.9	3,660.1	4,427.5	823.2	(91.1)	(266.0)	16,809.9	2,132.6	16,678.7	11,226.6

Table 11
Estimates of Assistance Payments
Summary of Transactions

(In $ Millions)

Type of Transaction	FRF Payments: Cash	Note Principal	Note Interest	Yield Maint	Capital Losses	Other Payments	FRF Receipts: (Tax Sharing)	(Other Receipts)	Net Total	Totals: Prior to 1/1/90	After 12/31/89	After 12/31/89 (PV)
Cash	332.1	0.0	0.0	0.0	0.0	5.0	(4.6)	(7.3)	325.2	324.1	1.7	2.3
Small	533.3	438.1	274.2	29.9	68.4	31.6	(27.5)	(11.2)	1,336.8	649.9	686.9	426.5
Large	531.0	3,229.1	1,695.8	960.6	693.1	209.9	(180.5)	(127.9)	7,231.1	1,209.5	6,021.5	4,471.1
Mega	33.4	10,706.8	9,096.3	13,728.0	8,776.1	2,414.5	(1,663.8)	(1,156.4)	41,914.8	2,858.8	39,057.7	24,818.2
Under Gov't Control	56.5	5,439.6	4,762.8	3,660.1	4,427.5	823.3	(91.1)	(288.0)	18,809.9	2,132.0	16,678.7	11,226.0
Totals	1,486.3	19,813.6	15,829.3	18,378.6	14,165.1	3,484.2	(1,967.5)	(1,571.7)	69,617.9	7,172.0	62,446.5	41,044.1

COVERED ASSET DISPOSITION

A key determinant of the future cost of the specific deals is the rate of disposition of the covered assets, and this has, for most transactions, been an area of considerable confusion and much disappointment. In particular, of the 13 largest non-government controlled institutions, in only five instances has the rate of disposition been greater than 10 percent in the first full year after acquisition. The results in these 13 cases are presented in Table 12 on the following page.

The institutional net decrease in covered assets is somewhat deflated by additions to the original base from capitalized expenses and from uncovered assets moving from performing to nonperforming and becoming "covered". The net decrease is also somewhat inflated by writedowns in the book values of covered assets. However, in both cases the impact is not believed to be significant.

In the two cases with the largest declines in covered assets (New West FS&LA and United SA of Texas), the declines have come principally from the sale of mortgage backed securities and similar investments. If mortgage backed securities were removed from covered assets at the inception date, the over all decline would be less by approximately $16.1 billion. The combined percentage change for all 13 institutions would decline to 16.6

TABLE 12

Covered Asset Disposition
Institutions with Covered Assets
In Excess of $500 Million

Institution	Covered Assets Effective Date ($ Millions)	Covered Assets December 31, 1989 ($ Millions)	Percent Change
New West FS&LA	$21,425	$4,940	(76.9)
First Gibralter Bank, FSB	4,469	3,683	(17.6)
First Nationwide Bank, Fin. Corp. (Pathway, Cardinal, Columbia)	5,315	3,650	(31.3)
Amwest SA	1,985	2,231	12.4
American Federal Bank, FSB	1,863	1,696	(9.0)
Bluebonnet SB, FSB	1,695	1,716	1.2
Guaranty FSB	1,682	1,642	(2.4)
United SA of Texas, FSB	2,966	1,235	(58.6)
First Heights Bank, A FSB	1,166	1,079	(7.5)
Franklin Federal Bancorp, FSB	997	914	(8.3)
Beverly Hills FSB	786	637	(19.0)
Superior Bank, FSB	565	520	(8.0)
Pacific Southwest Bank, FSB	557	558	0.2
	$45,491	$24,501	(46.1)

percent and the individual changes would decline to 24.7 percent and 28.7 percent at New West FS&LA and United SA of Texas, respectively.

The reasons for the slow rate of disposition in the early stages of these assistance agreements are many, and not all of the responsibility lies with the institutions. The agreements included disincentives to dispose of the covered assets and at the outset it was unclear that the assets should be moved as rapidly as possible. In many cases, holding the assets could conceivably increase the return for all parties including the government, and it appears that the high priority of a rapid disposition was not clearly enunciated until the end of 1989.

Rapid disposition has also been hindered by negative market conditions and the procedures installed by FSLIC and FDIC to assure the maximization of recoveries. Most covered assets are in the Southwest, which is only beginning to recover from an economic recession, and in parts of the region the recovery has not even begun. In addition, all major and significant covered assets require extensive business plans and approvals from the FDIC. In many cases a private sector monitoring agent also reviews both the plans and proposed sales prior to FDIC's review and approval (FDIC oversight and monitoring is discussed below). Even under the best of conditions this approval process has been cumbersome.

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Although the merits of the disposition of covered assets process could be debated at some length, the process has undoubtedly proceeded slowly and that slow disposition may be costly to the government.

INCENTIVES

Clearly, one of the best available options for reducing the overall cost to the government is for the assisted institutions to sell the covered assets more quickly. This would reduce high cost yield maintenance provisions as well as the associated tax benefits. However, the FSLIC Assistance Agreements contained six provisions that may discourage prompt liquidation of covered assets as well as create an indifference to maximization of value upon disposition. These disincentives are: 1) guaranteed yield maintenance, 2) capital loss coverage, 3) mark-to-market of assets at termination, 4) gain/loss sharing, 5) asset management fees, and 6) tax benefits. These provisions are all interrelated within the context of covered assets.

GUARANTEED YIELD MAINTENANCE

Guaranteed yield maintenance was offered by FSLIC in order to persuade the acquiring institution to keep a troubled asset. It was felt that the acquirer could better manage and work out a

poorly performing loan or real estate owned (REO), which reduced the real estate burden on FSLIC. Also, FSLIC could postpone a demand upon its cash resources by offering yield maintenance on an asset, rather than negotiating and paying a sales price in lieu of the yield guarantee at the time of resolution. The guaranteed yield also had the beneficial consequence for the acquiring institution of avoiding the necessity of reinvesting a large amount of cash at the time of resolution if FSLIC had reimbursed the acquirer for all capital losses in a one-time mark-to-market payment in lieu of continuing assistance.

However, where yield maintenance is tied to assets, there are two significant adverse incentives. First, because some agreements provide for an initial spread of as much as 275 basis points over the defined base cost of funds, the current achievable spread cannot be easily replaced with comparably high after tax yields on taxable assets obtained in private sector markets. Consequently, an incentive exists to delay asset disposition on covered assets.

Second, there is an incentive to minimize the income produced by assets under yield maintenance, because the lost taxable income stream will be replaced dollar for dollar by tax exempt income. Moreover, the greater operating losses involved create more net operating losses (NOLs) that can be used to shield taxable income from other assets or affiliated entities.

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Most agreements called for a declining yield spread over the term of the assistance agreement. In general, this does not appear to have a marked influence on the rates of disposition of covered assets, since the scheduled declines in yield spreads have not yet resulted in material differences in the amount of yield maintenance payments.

CAPITAL LOSS COVERAGE

As mentioned above, the effect of capital loss coverage is, in part, tied to the guaranteed yield maintenance. An acquirer receives a guarantee against any loss on the covered asset, and at the same time is protected against an income loss incurred for carrying the asset. The larger tax losses created by delaying disposition can be used as NOLs to shield taxable income from other assets or consolidated entities. As a result, the acquirer has a compelling incentive to hold the asset.

Furthermore, since the acquirer receives capital loss payment upon disposition, which will be measured from book value, the acquirer is insulated from downturns in the real estate market.

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MARK-TO-MARKET AT TERMINATION

Where applicable, the mark-to-market provisions give acquirers the ultimate protection of being entitled to have any unsold covered asset marked-to-market at the end of the term of the agreements or some other specified period. This protection reinforces any inclination to hold assets for which capital loss coverage and yield maintenance is paid. While the agreements with this provision contain provisions to reconcile differences of opinion on fair market values including arbitration the FDIC can expect to have a difficult time resolving differences of opinion.

In one 1988 transaction, with capital loss coverage and guaranteed yield maintenance, coverage is scheduled to expire on December 31, 1990. However, the FDIC and the acquirer have not been able to agree on how fair market value should be determined under the mark-to-market provision and it is likely that tax-free yield maintenance and capital loss coverage will be extended an additional two years as allowed in the agreement.

GAIN/LOSS SHARING

Some assistance agreements call for both loss sharing and gain sharing in order to provide an incentive to increase the rate and amount of recoveries. Even when the agreement provides

for some loss sharing, the financial effect appears to be small enough that the institution will not attempt to cut its losses, at least as long as the asset is subject to guaranteed yield.

In a similar manner, gain sharing appears likely to be ineffective as an incentive, since gains are usually calculated net of historical book value, including the failed institution's built-in capital losses. Unless the book value of the asset has been written down prior to disposition, or unless the built-in losses are eliminated through greatly improved market conditions, it is unlikely that most covered asset dispositions will result in gains. Moreover, the institution benefits from any significant appreciation in the asset's value without regard to its carrying costs.

ASSET MANAGEMENT FEES

Certain acquirers are allowed to charge asset management fees in specific situations. Fees are usually paid for services rendered by separately organized subsidiaries or affiliates that were and remain in the business of providing services that are required. However, despite close monitoring of these services by FDIC, the fees may tend to discourage sales of managed assets due to the loss of fee income to the consolidated entity when the assets are sold.

TAX BENEFITS

The existence of tax benefits complicates both the propensity to hold assets and the goal of maximizing gain and minimizing loss. Simply stated, the special tax provisions included in the IRC that are applicable to the 1988-1989 FSLIC Assistance Agreements operate to make available from the Internal Revenue Service ("IRS") additional money over and above the tax-free assistance on every FSLIC reimbursable loss and expense incurred by the acquirer. This additional amount is equal to the loss or expense times the existing tax rate. State tax benefits may provide additional amounts.

To the extent that the FSLIC captures all of this amount, the acquirer is in no different position than if the FSLIC payments were treated as taxable income, and the tax provisions should have no effect on the acquirer's actions with respect to covered assets and expenses. However, to the extent a share of the amount available from the IRS is provided to the acquirer, the acquirer has an incentive to act in exactly the opposite manner that is desirable.

Since the amount available from the IRS grows in direct proportion to the reimbursable losses and expenses incurred by the acquirer, it is in the acquirer's interest to maximize losses and expenses and minimize gains.

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This is equally true with reimbursable expenses and yield maintenance. Since attorneys, accountants, management and brokerage fees are tax deductible, to the extent such costs are reimbursable under the terms of the assistance agreement, the acquirer maximizes its return by maximizing such costs. Since yield maintenance is tax-free but actual yield is not, the acquirer who shares in tax benefits will be better off minimizing an asset's actual yield so as to maximize the FSLIC's contribution of yield maintenance.

Thus, sharing of tax benefits does more than create an indifference to loss, it creates an incentive to maximize losses. The effect of tax sharing on an acquirer's decision to hold or sell an asset is more complicated. Although maximization of loss might suggest immediate dumping of assets, this is normally offset by the ability to receive yield maintenance, and a part of its tax benefit, as well as the tax benefit inherent in reimbursed expenses incurred over time. Thus, tax sharing probably does not overcome an otherwise existing bias to hold assets.

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FDIC OVERSIGHT AND MONITORING

BASIC STRUCTURE

Upon the execution of the assistance agreements, the FSLIC was charged with the monitoring and oversight responsibilities associated with the agreements. Subsequent to the enactment of FIRREA, the responsibilities were shifted to the FDIC and its newly formed Division of FSLIC Operations ("DFO").

DFO case managers are assigned to each assisted transaction. For conventional transactions, a case manager may have several transactions assigned for monitoring. Typically, Southwest Plan transactions are monitored by two individuals: a claims review specialist who coordinates the reviews of the quarterly reports and handles any accounting issues and an "asset" case manager who monitors liquidation efforts, litigation matters and other operational type issues. The claims review specialist may monitor several institutions whereas the asset case manager is dedicated solely to one institution.

The case managers are primarily responsible for review of assistance agreement reporting requirements (asset plans, approval requests, etc.), clarification of differences in interpretations of the agreement and overall monitoring of the institutions's financial condition, consolidation process,

liquidation efforts, etc. In many cases, especially Southwest Plan transactions, case managers are assisted by outside "monitoring" contractors. These contractors perform procedures as directed by the case managers. The majority of the procedures relate to agreed-upon procedures testing of the quarterly reports and reviewing liquidation efforts. Often these contractors are requested to perform analyses of liquidations, etc. In many cases these contractors serve as DFO staff. As they are on-site at the institution, they often provide information to the case manager regarding the inside workings of the institution.

The case managers have delegated authority to approve sales or other dispositions of covered assets, writedowns, loans-to-facilitate, etc. Assistance in specialized areas such as law or accounting is provided by the FDIC Legal Division at the district FDIC office or in Washington, D.C., and other divisions within the FDIC. If approval requests exceed the case managers authority, the request moves up the lines of authority and finally to Washington, D.C.

ASSISTANCE AGREEMENT AUDIT PROVISIONS

For most conventional transactions and all Southwest Plan transactions, the assistance agreements required an initial audit of the acquired institution as of the effective date of the transaction. These audits were used to determine the negative

net worth of the acquired institution that was covered by the FSLIC (usually through the issuance of a promissory note). In most cases the initial audits have been completed.

The Washington office of the DFO is primarily responsible for monitoring for compliance of the income tax provisions and tax sharing computations. The DFO is also responsible for filing or preparing the final tax returns for the acquired institutions in cases where the FSLIC was appointed receiver prior to the assisted acquisition.[6] Many resultant institutions have not yet filed their returns and are waiting on the position taken by the FDIC in the treatment of tax basis carry-forwards, net operating loss carry-forwards, etc. Several of the institutions, primarily those who are a member of a consolidated group, have filed their returns.

ASSISTANCE AGREEMENT REPORTING REQUIREMENTS

The institutions which receive coverage on acquired assets are required to prepare asset plans, property plans, budgets, marketing analysis and similar information on each significant asset. These plans are reviewed by the case manager and, if applicable, the monitoring contractor. Often there is a significant time delay in the review and approval of these items.

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[6]In cases where the failed institution was part of a consolidated group, FDIC prepares the tax return information for the failed institution's parent organization to file with the IRS.

The institutions are generally not reimbursed for related expenses until approval of the plans has occurred.

In addition to plans and budgets, the institutions must submit approval requests for sales of covered assets. In some instances, usually on the smaller covered assets, approval by the case manager is not necessary if the sale meets certain criteria, such as when the sale proceeds fall within a prescribed percentage of the fair value. When attempting to provide financing for asset sales, the institution must prepare a term sheet which details the specifics of the transaction. Such loans-to-facilitate fall under strict rules as to percentage of book value which can be financed. Exceptions to these rules are made on a case-by-case basis.

PROBLEMS ENCOUNTERED

The format of the budget and asset plans as required by case managers and monitoring contractor has been changed several times. Formats were not agreed upon until up to six months into the contract which hindered the acquirers' ability to complete asset plans and budgets on a timely basis. Requests are also made to provide additional information and calculations such as yield maintenance based on anticipated disposal dates. While the information may be helpful to the case manager in deciding whether or not to approve a sale, acquirers generally contend

that trying to project such activity is a guess at best and is beyond the realm of what was originally contemplated under the agreement.

The time involved in preparing asset plans is significant. One acquirer estimated that the cost of preparing such a plan for a single property was approximately $4,500. After recent changes in plan format, this estimate increased to $7,500 per plan. This specific institution has several thousand assets which require such plans.

As asset plans and budgets are completed, the case managers and monitoring contractors are encountering difficulty in dealing with the volume of information and, consequently, have fallen behind in the approval process. In one instance, the asset plans were essentially completed within twelve months of the effective date of the acquisition, but approvals were only approximately 50-60% complete seven months later. The lack of approval results in the acquirer having to submit "specific requests" for any activity or disbursement regardless of the dollar amount involved. The volume of "specific requests" is so significant that the case manager encounters further backlogs in attempting to grant approvals in a timely manner. This situation makes it difficult for the acquirers as well as case managers to focus attention and resources on more critical matters such as marketing efforts.

The problems reportedly being encountered by acquirers as a result of the delay in receiving approvals for covered asset plans are many and not all the fault rests with FSLIC and subsequently the FDIC. In many instances, delays were caused by extremely poor quality submissions by acquirers, and not simply resulting from the concentration of plans submitted at the end of the first year and from the lack of DFO staff. While it is clear that the paper burden on both acquirers and the FDIC has been overwhelming, it must be noted that annual updating will be far less burdensome for all concerned.

In evaluating the present oversight and monitoring scheme, fairness dictates that the acquirers' incentives for holding assets in order to maximize the benefits of yield maintenance must be taken into consideration. An independent observer indicated that one acquirer indicated to him that the recent change in plan formats will allow the acquirer to keep all loan workout staff busy for months. The perverse result for the government is higher yield maintenance payments and tax benefits while the new reports are prepared. In some cases it is certainly in the acquirer's best interest to delay disposition.

It is also important to remember that during the past two years much has occurred to contribute to the delays. FSLIC effectively ceased to exist during the months prior to the

signing of FIRREA. Moreover, the transfer of responsibility for the FSLIC Assistance Agreements from FSLIC to FDIC took some time after FIRREA had been signed.

The FDIC's efforts to address the problems with the present oversight and monitoring structure have included:

- The adoption of a three-year strategic plan in June 1990, relating to the administration of the assistance agreements. A main component of this plan is the establishment of three-year disposition targets for each of the acquirers with capital loss coverage.

- Seventy new case manager positions were authorized for deployment to the FDIC's Dallas, Houston and Irvine (California) field offices.

- A formal on-site visitation program was recently begun. These visits are designed to assess the quality of the acquirers' management of covered assets and their adherence to DFO and their own internal policies and procedures.

- The use of special investigators to verify complaints and lack of asset marketing efforts. The investigations are conducted without the acquirers' knowledge.

- The FDIC's Inspector General conducts periodic audits to validate assistance claims paid by the FRF.

CHAPTER IV

OPTIONS FOR COST REDUCTIONS

INTRODUCTION

This chapter presents the RTC's conclusions of the review of the FSLIC Assistance Agreements. The chapter includes discussions of:

- RTC's Rights Under FIRREA
- FSLIC's Rights Under The Agreements
- Opportunities For Reducing Costs
- Tax Issues
- Oversight and Monitoring
- Survivability Issues
- Options For The Future

RTC'S RIGHTS UNDER FIRREA

As an introduction to this chapter which concentrates on the opportunities and options for cost reduction, it is useful to revisit the RTC's mandate for this review. Section 21A(b)(11)(B) of the Federal Home Loan Bank Act ("FHLBA"), as amended by

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Section 501 of FIRREA, directs RTC to "review and analyze all insolvent institution cases resolved by the [FSLIC] between January 1, 1988 and the date of enactment of [FIRREA], and actively review all means by which it can reduce costs under existing [FSLIC] agreements relating to such cases, including restructuring such agreements...." Section 21A(b)(11)(B) further directs that "(t)he [RTC] shall exercise any and all legal rights to modify renegotiate or restructure such agreements where savings would be realized by such actions." Section 501 further provides:

> "Nothing in this paragraph shall be construed as granting the [RTC] any legal rights to modify, renegotiate, or restructure agreements between [FSLIC] and any other party, which did not exist prior to the date of enactment of [FIRREA]."

Attached as Appendix IV to this report is an opinion prepared by the law firm of Baker & Hostetler on the authority of RTC to modify, renegotiate, or restructure the FSLIC Assistance Agreements. This opinion concludes:

> "Based upon (i) the clear and unambiguous language employed by Congress in Section 21A(b)(11)(B) of FHLBA, as amended by Section 501 of FIRREA; (ii) the legislative history of the section, discussed [in this opinion] and (iii) the judicial

decisions discussed [in this opinion], we are of the opinion that FIRREA does not grant RTC new legal rights to abrogate or repudiate unilaterally the agreements entered into by FSLIC and referred to in Section 21A(b)(11)(B) of FHLBA as amended by FIRREA. To the extent that RTC succeeds to the contractual rights of FSLIC for the purpose of modifying, renegotiating, or restructuring the [FSLIC Assistance] Agreements it has the same, but unenhanced, statutory and common law rights that were available to FSLIC before enactment of FIRREA."

FSLIC RIGHTS UNDER THE ASSISTANCE AGREEMENTS

Essentially, all FSLIC Assistance Agreements contained a basic package of rights, monetary and non-monetary, to FSLIC. Additional, unique provisions relate to selected larger more complex transactions. In general FSLIC, and now FDIC's Division of FSLIC Operations, has the right to:

- Prepay the FSLIC promissory notes issued to the acquirer. In some cases, prepayment is limited to a specified amount and/or may occur only on selected dates.

- Require the write-down of covered assets to fair market

value or purchase covered assets at fair market value. The loss associated with an approved write-down or purchase at fair market value would be reimbursed by the FRF. Under a buy back arrangement, the DFO would be responsible for managing as well as disposing of the asset. In some cases, write-downs and purchases by the DFO are limited to specific amounts or categories of assets and/or may occur only on selected dates.

- Exercise rights under a variety of capital stock or warrant arrangements.

- Exercise rights to take over majority voting power or shares of the institution if the acquirer does not meet required regulatory capital or does not comply with other agreement provisions.

- Withhold payments if reporting requirements or proper approval processes are not met.

- Assume claims and litigation.

OPPORTUNITIES FOR REDUCING COSTS

The principal costs of the FSLIC Assistance Agreements result

from:

- The FSLIC promissory notes issued to fill the negative net worth balances (before and after the purchase of selected assets) that existed at the date of acquisition.

- Capital loss payments resulting from the dispositions of covered assets for less than the "covered" value.

- The payment of the minimum yield guarantees.

- The tax benefits afforded the acquirer.

- Administrative costs.

A large percentage of the covered assets are worth materially less than book or "covered" value. There is, therefore, little that can be done to reduce the loss that FRF will suffer when they are sold. However, some steps can be taken to be certain that the highest values are received for these assets. Moreover, other cost components are susceptible to significant cost reduction measures. These measures include:

- FSLIC promissory notes can be prepaid at the earliest opportunity.

- Book values of covered assets can be written down to fair market values to reduce the cost of the yield maintenance payments.

- Covered assets can be purchased at fair market values to eliminate the cost of yield maintenance payments.

- The troubled (covered) assets can be disposed of faster to terminate the higher than market guaranteed minimum yields.

- The yield maintenance rates can be renegotiated downward toward market rates.

- Tax treatment of assistance and built-in losses, as well as the rights of FDIC to ratably share in in-substance dividends, can be clarified. For example, where capital loss payments are tax free, thereby relieving the tax payer of any tax liability associated with these payments, the tax payer is also allowed to apply these same losses against current or future income. This is the so-called "double dip" issue.

- The monitoring, oversight and approval procedures can be modified to expedite the disposition of assets and reduce administrative costs.

- In some transactions the assistance agreements can effectively be terminated through prepayments, thereby eliminating the expenses associated with monitoring and oversight.

Each of the opportunities for reducing costs is discussed in the following pages.

PREPAYMENT OF FSLIC PROMISSORY NOTES

As of July 1, 1990 the acquirers of failed thrifts subject to the RTC review held approximately $18.8 billion in FSLIC promissory notes issued in 1988. The following table summarizes the notes outstanding by: (1) category of institutional holder (FDIC or RTC control); (2) prepayment ability (dates and conditions); and (3) the potential to recognize cost reductions from prepayment. At the back of this section is a list of all FSLIC promissory notes outstanding as of July 1, 1990.

FSLIC PROMISSORY NOTES ISSUED IN 1988
($ Billions)

		----Institutional Holder---- Not Under FDIC or RTC Control	Under FDIC or RTC Control
Potential Savings			
Available if Prepaid			
Prepayable before 12/31/90	(1)	$ 5.8	$ 5.3
Prepayable after 12/31/90	(2)	4.3	-
Conditionally Prepayable	(3)	1.2	-
		$11.3	$ 5.3
No Potential Savings			
Available if Prepaid			
Prepayable before 12/31/90	(4)	$ 1.0	$ 0.1
Prepayable after 12/31/90		-	-
Conditionally Prepayable	(5)	1.1	-
		$ 2.1	$ 0.1

Notes: (1) These notes contain no prepayment restrictions other than short notice requirements.

(2) These notes can only be prepaid on an anniversary date or prepayment is restricted to a certain percent of the balance outstanding each year.

(3) These notes, held by First Gibraltar Bank, FSB, have potentially significant prepayment penalties tied to the economic detriment suffered by the holder as a result of prepayment.

(4) These notes pay interest rate below one year U.S. Treasury borrowing rates.

(5) These notes generally restrict prepayment until all other notes with higher rates have been prepaid. The rates on these notes are generally below one year U.S. Treasury borrowing rates.

In many cases, the assistance agreement provided FSLIC the right to prepay promissory notes that were issued to offset the negative net worth of the institution. The notes bear interest at a base rate tied to movements in deposit costs plus a

specified number of basis points; the total floating or adjustable rate almost uniformly exceeds the Treasury borrowing rate on short term obligations. Prepaying the promissory notes at the earliest opportunity under the terms of the agreements will result in substantial savings on a present value basis.

Based on the modeling parameters used by the contractors (see Appendix III to this report) the estimated savings, before tax sharing payments to FRF, of prepaying at the earliest opportunity, the $10.1 billion in notes held by acquirers not under FDIC or RTC control is estimated to be approximately $440 million on a present value basis as of December 31, 1990.[7] This savings estimate assumes that the Texas Cost of Funds (TCOF), the most prevalent interest rate index, ranges from 65 to 75 basis points, higher than the yield on one year U.S. Treasury securities adjusted to a constant maturity. This one year U.S. Treasury rate is the assumed interest cost that the government as a whole will pay to refinance the notes. Other indices used in calculating interest payments on notes are more fully described in Appendix III.

If proceeds from the prepayment of the promissory note were reinvested by the holders in taxable investments at market rates,

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[7]The contractors' estimates of savings are on a present value basis as of January 1, 1990. Since no prepayment is expected to occur until 1991, RTC has adjusted the contractors' estimates to reflect the savings on a present value basis as of January 1, 1991.

then the nontaxable interest payments would be replaced with taxable interest income. The additional taxable income may enable the use of pre-acquisition net operating losses which previously were not expected to be used. The net operating losses would result in current cost savings only if some portion of the tax benefits were shared with FRF under that assistance agreement. If nothing was shared with FRF, the substitution of taxable income for tax-free assistance income will not result in additional savings to the Treasury to the extent that losses utilized to offset the newly generated taxable income were previously thought to be unusable. To the extent that such losses were presumed to be used at some point in time, the savings to the Treasury will occur in later years when the losses have expired or been totally absorbed.

The taxable income resulting from the substitution of taxable income for nontaxable income may accelerate the use of post-acquisition net operating losses. While this substitution of income may not result in immediate savings to the Treasury, it should result in additional tax revenues in future years after these losses have been absorbed and the taxable income is no longer sheltered by the post-acquisition losses. If the assistance agreement provided for tax sharing with FSLIC on the use of the post-acquisition losses, the earlier use of such losses will provide a net benefit to the Treasury on a present value basis.

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The tax effect of any individual institution option must be analyzed in view of the interaction between the tax sharing aspects of the assistance agreements, the pre-and post-acquisition net operating loss carryover position, the substitution of taxable for nontaxable interest income and the status of the acquired institution and any consolidated group of the acquired institution.

It should be emphasized, however, that irrespective of the tax position of the holders, under no circumstances will this cost be higher to the government if tax free income is converted to taxable income.

Despite the problems with estimating the effect prepayment will have on tax revenues and tax benefits shared with FRF discussed above, some of the holders of the promissory notes are owned by corporate parents that appear to be generating significant taxable income. In these instances the contractors estimated that the conversion of the tax free interest income to taxable income could add approximately $300 - $400 million in additional net saving to the government as a whole on a present value basis, adjusted to January 1, 1991. The total savings to the government as a whole is therefore estimated to be $740 to $840 million on a present value basis.

In addition to the savings estimated by the contractors, the

government as a whole could potentially realize significant savings from prepaying: (1) the $5.3 billion in FSLIC notes held by institutions under FDIC and RTC control; and (2) the $1.2 billion in FSLIC notes with potential prepayment penalties held by First Gibraltar Bank, FSB.

The FDIC and RTC presently control 12 institutions involved in FSLIC assisted transactions in 1988; 11 of which hold FSLIC notes. Of the 11, three account for $4.9 of the $5.3 billion held by FDIC and RTC controlled institutions. Each of these institutions (Sunbelt, Merabank and Southwest) have Federal Home Loan Bank of Dallas advances outstanding in excess of the balance of FSLIC notes held. While the RTC and FDIC's objective is to permanently resolve these institutions as soon as possible, the government can save money by prepaying the $4.9 billion in FSLIC notes and paying off the higher cost FHLB advances. If the U.S. Treasury refinanced these notes at costs, assumed to be 75 basis points lower that the effective rate on the advances, the government as a whole can save approximately $37 million per year.

The $1.2 billion in notes held by First Gibraltar Bank, FSB were issued by FSLIC in its corporate capacity and given to FSLIC as receiver for three of the failed thrifts acquired by First Gibraltar. The notes were given in exchange for certain non-qualifying assets of the three acquired institutions. The terms

of the notes state that FSLIC may not prepay any portion of the principal balance of the note in cash without adjustment. The adjustment clause in the notes is not clear, but can be read to require a prepayment adjustment equal to the economic loss realized by First Gibraltar from the prepayment, compared to the benefits they would have realized if they retained the assets now owned by FSLIC, as receiver. If this clause was not in the notes, prepayment of the notes could potentially save the government as a whole on a present value basis approximately $100 million without considering the tax free nature of interest on the notes. Conversion of tax free interest from the notes to taxable income from the reinvestment of proceeds, could potentially add an additional $250 million (present value) in future tax revenues to the U.S. Treasury. Before considering the cost of the adjustment clause, the total savings to the government, on a present value, is potentially about $350 million.

FSLIC NOTE SUMMARY BY NOTE HOLDER

HOLDER'S NAME	7/1/90 OUTSTANDING BALANCE OF NOTE (In $ Thousands)	MATURITY DATE	INITIAL REPRICING INDEX	ENDING REPRICING INDEX
POTENTIAL SAVINGS ON PREPAYMENT				
PREPAYABLE IN FULL BEFORE 12/31/90:				
PACIFIC	151,839	12/29/96	TXCOF + 260BP	TXCOF + 185BP
COASTAL BANC	41,972	06/30/96	TXCOF + 225BP	TXCOF + 170BP
RIVER VALLEY SB,FSB	13,200	12/31/96	LIBOR + 175BP	LIBOR + 175BP
WASHINGTON FEDERAL	30,965	09/16/96	LIBOR + 150BP	LIBOR + 150BP
AMWEST	85,541	10/14/96	TXCOF + 200BP	TXCOF + 100BP
CITIZENS FEDERAL BANK	25,000	12/29/95	FIXED 9.35%	FIXED 9.35%
FRANKLIN	290,457	09/30/96	TXCOF + 50BP	TXCOF + 50BP
TEXAS TRUST SB	167,266	12/29/96	TXCOF + 50BP	TXCOF + 50BP
UNITED SA OF TEXAS FSB	309,544	12/30/96	TXCOF + 50BP	TXCOF + 50BP
AMERICITY FSB	31,561	11/16/96	TXCOF + 49.75BP	TXCOF + 49.75BP
BLUEBONNET	760,200	12/22/96	TXCOF + 45BP	TXCOF + 40BP
AMERICAN FEDERAL BANK	630,894	09/16/96	TXCOF + 40BP	TXCOF + 40BP
AMWEST	67,466	10/14/90	TXCOF + 80BP	TXCOF + 80BP
BEACH FSLA	1,061,194	12/29/93	11TH DIST COF + 175BP	11TH DIST COF + 175BP
GUARANTY FSB	710,146	09/30/96	TXCOF + 40BP	TXCOF + 40BP
EQUITY BANK OF SAVINGS	40,390	09/31/96	10TH DIST COF + 50BP	10TH DIST COF + 50BP
AMWEST	32,255	10/14/96	TXCOF + 200BP/ADV	TXCOF + 100BP/ADV
DOWNEY S&LA	222,968	01/10/96	11TH DIST COF + 125BP	11TH DIST COF + 125BP
PACIFIC	129,272	12/29/96	TXCOF + 50BP/ADV	TXCOF + 50BP/ADV
AMWEST	243,527	10/14/96	TXCOF + 90BP/ADV	TXCOF + 90BP/ADV
CALIFORNIA FSLA	97,395	12/31/96	26WK COUPON + 75BP	26WK COUPON + 75BP
METROPOLITAN FB IOWA	58,263	12/28/96	26WK COUPON + 100BP	26WK COUPON + 100BP
NORTHWEST FSB	51,577	12/30/96	26WK COUPON + 100BP	26WK COUPON + 100BP
METROPOLITAN FB	295,009	06/26/96	26WK COUPON + 100BP	26WK COUPON + 100BP
LOCAL AMERICA	39,757	12/29/93	10TH DIST COF + 50BP	10TH DIST COF + 50BP
ROCKY MOUNTAIN FSB	117,578	12/15/93	26WK TBILL + 100BP	26WK TBILL + 100BP
PACIFIC FIRST BANK	83,418	12/15/93	26WK COUPON + 50BP	26WK COUPON + 50BP
TOTAL NOTES PREPAYABLE IN FULL BEFORE 12/31/90	$5,786,711			

FSLIC NOTE SUMMARY BY NOTE HOLDER

HOLDER'S NAME	7/1/90 OUTSTANDING BALANCE OF NOTE (In $ Thousands)	MATURITY DATE	INITIAL REPRICING INDEX	ENDING REPRICING INDEX
PREPAYABLE AFTER 12/31/90:				
GUARANTY FSB (Sep.91)	364,342	09/30/98	TXCOF + 230BP	TXCOF+ 165BP
HEIGHTS OF TEXAS (Dec.90)	76,399	09/30/98	TXCOF + 240BP	TXCOF + 155BP
FRANKLIN (Sep.91)	188,439	09/30/94	TXCOF + 250BP	TXCOF + 220BP
BEVERLY HILLS SAVINGS (Jan.91)	811,466	12/31/99	11TH DIST COF + 200BP	11 DIST COF + 80BP
SUPERIOR BANK (Jan.91)	206,911	12/30/98	7TH DIST COF + 140BP	7TH DIST COF + 140BP
FIRST HEIGHTS BANK (Dec.90)	239,201	09/23/98	TXCOF + 40BP	TXCOF + 40BP
WESTERN FEDERAL (Sep.91)	464,088	09/23/93	26WK COUPON + 175BP	26WK COUPON + 175BP
FIRST GIBRALTAR (Dec.93)	1,944,066	12/28/98	TxCOF + 80BP (90%)	TXCOF + 80BP (90%)
TOTAL NOTES PREPAYABLE AFTER 12/31/90	$4,314,912			
CONDITIONALLY PREPAYABLE NOTES:				
FIRST GIBRALTAR	1,243,387	12/28/98	TXCOF + 225BP (90%)	TXCOF + 150BP (90%)
TOTAL NOTES WITH POTENTIAL SAVINGS ON PREPAYMENT	$11,347,020			

FSLIC NOTE SUMMARY BY NOTE HOLDER

HOLDER'S NAME	7/1/90 OUTSTANDING BALANCE OF NOTE (in $ Thousands)	MATURITY DATE	INITIAL REPRICING INDEX	ENDING REPRICING INDEX
NO SAVINGS ON PREPAYMENT				
PREPAYABLE BEFORE 12/31/90:				
HOME FED	283,329	12/30/93	26WK COUPON + 10BP	26WK COUPON + 10BP
FIRST NATIONWIDE BANK	86,250	10/10/95	26WK COUPON - 100BP	26WK COUPON - 100BP
NEW WEST FSLA	468,683	12/28/98	FIXED 7%	FIXED 7%
STANDARD FEDERAL	15,429	06/11/95	26WK TBILL + 150BP (64.6105%)	26WK TBILL + 150BP (64.6105%)
FIRST NATIONWIDE	174,862	12/16/98	26WK COUPON - 200BP	26WK COUPON - 200BP
TOTAL NOTES PREPAYABLE BEFORE 12/31/90	$1,028,552			
PREPAYABLE AFTER 12/31/90:				
NORTHWEST FSB	10,000	12/30/98	26WK COUPON + 100BP	26WK COUPON + 100BP
CARDINAL FSB	14,000	12/30/98	26WK COUPON + 25 BP	26WK COUPON + 25 BP
PATHWAY FINANCIAL	255,000	12/30/98	26WK COUPON + 25 BP	26WK COUPON + 25 BP
COLUMBIA SAVINGS, a FSLA	148,185	12/30/98	26WK COUPON + 25 BP	26WK COUPON + 25 BP
COLUMBIA SAVINGS, a FSLA	426,013	12/30/98	26WK COUPON -125BP	26WK COUPON -125BP
CARDINAL FSB	218,000	12/30/98	26WK COUPON -125BP	26WK COUPON -125BP
TOTAL NOTES PREPAYABLE AFTER 12/31/90	$1,071,198			
TOTAL NOTES WITH NO POTENTIAL SAVINGS ON PREPAYMENT	$2,099,750			

FSLIC NOTE SUMMARY BY NOTE HOLDER

HOLDER'S NAME	7/1/90 OUTSTANDING BALANCE OF NOTE (In $ Thousands)	MATURITY DATE	INITIAL REPRICING INDEX	ENDING REPRICING INDEX
OTHER NOTES OUTSTANDING BUT UNDER GOVERNMENT CONTROL:				
GREAT WEST SB	1,250	03/04/03	FIXED 10%	FIXED 10%
MERABANK TEXAS	425,744	09/25/96	TXCOF + 200BP	TXCOF + 180BP
SUNBELT SAVINGS, FSB	1,250,000	09/19/96	TXCOF + 215BP	TXCOF + 135BP
SOUTHWEST SA	873,104	05/18/96	TXCOF + 40BP	TXCOF + 40BP
RED RIVER	14,161	09/31/96	10TH DIST COF + 50BP	10TH DIST COF + 50BP
CHISHOLM FSLA	21,496	09/31/96	10TH DIST COF + 50BP	10TH DIST COF + 50BP
SUNBELT SAVINGS FSB	2,216,212	09/19/96	TXCOF + 50BPIADV	TXCOF + 50BPIADV
MERABANK TEXAS	117,534	09/26/96	TXCOF	TXCOF
FIRST NETWORK FSB	32,812	12/30/96	11TH DIST COF + 200BP	11TH DIST COF + 25BP
MERABANK TEXAS, FSB	42,906	09/22/96	TXCOF	TXCOF
CIMARRON FSLA	213,210	07/29/93	ASSOC COF + 75BP	ASSOC COF + 75BP
STATESMAN BANK	35,771	03/11/93	26WK TBILL + 175BP	26WK TBILL + 175BP
ATLANTIC FINANCIAL	85,000	02/10/00	FIXED 7%	FIXED 7%
TOTAL NOTES UNDER GOVERNMENT CONTROL	$5,329,199			
TOTAL NOTES OUTSTANDING	$15,775,969			

PREPAYMENT OF THE AMERICAN SAVINGS BANK, FA/NEW WEST FS&LA INTERCOMPANY NOTE

As more fully disclosed in the general report prepared by the Mid America Institute for Public Policy Research on the American Savings, FS&LA, Stockton, California assisted acquisition, the structure of that transaction is unique. This transaction was the largest transaction among the 1988-1989 FSLIC case resolutions. It was also the only transaction structured as a good thrift/bad thrift.

The structure of this agreement resulted in the good thrift (American) keeping all the good assets and retail deposits and the bad thrift (New West) keeping the risky assets and the high cost deposits and liabilities. Before the acquirer's capital contributions the bad thrift had approximately $7.8 billion more in "book value" of bad assets than liabilities and the good thrift had $7.8 billion more deposits than good assets. To balance the assets and liabilities at both thrifts, the bad thrift issued the good thrift an $7.8 billion intercompany note. Under the terms of the assistance agreement FSLIC guaranteed that the proceeds from the liquidation of the bad thrift's assets would be sufficient for the bad thrift to pay principal and interest on the intercompany note.

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The note is structured as an adjustable rate note tied to the Eleventh 11th Federal Home Loan Bank District Cost of Funds. The spread over the index was initially set at 225 basis points for the first 18 months, decreasing to 200 basis points in the second 18 months and further decreasing to 175 basis points after 1991 through maturity at the end of 1998. As discussed in the prior section and Appendix III, the Eleventh District Cost of Funds has tended to move in the direction of short term rates on U.S. Treasury securities. Over the last five years this index has averaged 67 basis points over the yields on one year Treasury securities adjusted to a constant maturity. If the past relationship of the index to yield on one year Treasury securities remains the same the annual savings from refinancing this note with one year Treasury securities would be significant.

DFO has the option of directing New West to prepay the intercompany note in stated increments. The allowable prepayment amounts to 10 percent of the "original" principal balance during 1990, another 15 percent in 1991, and another 20 percent per year until the note is fully prepaid. As a result of an audit adjustment the balance of the note was approximately $8 billion as of June 30, 1990. If FRF is provided with sufficient funds and DFO directs prepayment to the maximum extent allowed the estimated savings to the government compared to the contractual terms is approximately $520 million on a present value basis.

The intercompany note is unlike FSLIC promissory notes in at least three significant ways:

(1) FSLIC is not the maker but rather a guarantor.

(2) The interest on the note is not tax exempt; New West's interest expense cancels out American's interest income in the parent's consolidated tax return.

(3) While FSLIC notes have been scored for Federal budget purposes in the fiscal year issued, payments by FSLIC for intercompany note payments must be appropriated and scored in the fiscal year paid.

Prepayment of the intercompany note will have significant effects on the Federal budget and the fiscal policies of the Treasury. However, if funds are provided to FRF to the extent necessary for FDIC to exercise its rights to direct prepayment of the note at the earliest opportunity, the cost savings will be substantial. The real savings on a present value basis would appear to more than compensate the government as a whole for the timing differences in budgetary outlays. The acquirer expects FDIC to continue to direct prepayment as it has in the first two calendar quarters of 1990.

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WRITE-DOWN OF COVERED ASSETS TO FAIR MARKET VALUE

Generally, the yield maintenance payments on covered assets are computed on the average book balances of covered assets at rates well in excess of short term Treasury borrowing rates. Many of the assistance agreements provided FSLIC with the right to write-down covered assets to fair market value, although several of the major transactions such as First Gibraltar, FSB and First Heights Bank, FSB, contain significant restrictions on the amount and timing of covered asset write-downs. To the extent that the book value of covered assets exceeds fair market value, that difference is loss that is in effect being financed at rates significantly above short term Treasury rates. Given the spread between the current yield maintenance and Treasury rates over the assumed liquidation period of the covered assets, writing the covered assets down to reduce the base upon which yield maintenance is paid and refinancing the write-down through Treasury borrowings would result in significant savings.

The same tax implications described above for the notes would also generally apply. The write-down of assets may have the effect of accelerating tax deductions attributable to the excess of the carryover tax basis of the asset over the fair market value. To the extent that such deductions have not been previously deducted or have been presumed to have been triggered in a later year (e.g., at the assumed date of disposition of the

asset to some third party), acceleration of the deductions could reduce the current tax revenues to the Treasury by lowering income taxes paid. In some of the agreements, the recognition of the deductions determines the timing of the tax sharing payment to FSLIC with respect to this item. Therefore, while the acceleration of this deduction may reduce the current tax revenue to Treasury, this reduction may be partially offset by the related tax sharing payments.

As discussed earlier in this report, estimating current fair market value for the covered assets is a subjective evaluation encompassing a number of uncertainties and carrying a degree of inaccuracy. Notwithstanding this uncertainty, data now exits to permit a reasonable estimation of the fair market value and therefore to make appropriate write-downs on covered assets.

In the transactions reviewed, the contractors estimated that direct cost savings of reducing the yield maintenance payments on these write-downs to Treasury rates would approximate $285 million on a present value basis. The contractors' estimates of savings on a present value basis are as of January 1, 1990. Since all action resulting in savings are expected to take place in 1991 and later years, RTC has adjusted the contractors' estimates to reflect present value savings as of January 1, 1991. As was the case with estimating the effect of note prepayments on future tax revenues to Treasury (net of lost sharing payments to

FRF) the contractors estimated that the conversion of tax free yield maintenance payments to taxable income could add approximately $250 million in net savings to the government as a whole on a present value basis adjusted to January 1, 1991.

The total potential savings to the government from writing down covered assets to fair market value is approximately $535 million. While this amount is significant, the required cash outlay necessary to accelerate the recognition of capital losses to the first calendar quarter of 1991 is estimated to be about $3.8 billion. This amount would need to be provided to FRF from appropriated funds. The early recognition of losses will reduce future year appropriations by the same amount plus the direct savings recognized by FRF from the action taken.

REPURCHASE OF SELECTED COVERED ASSETS

Land. Certain covered assets, primarily raw land with minimal maintenance costs, could be considered for acquisition by DFO. The assistance agreements in most cases provided FSLIC with the right to purchase covered assets at fair market value (or other basis). Accordingly, the contractors recommended that, DFO consider purchasing these assets, and placing them under centralized management.

Purchase of these assets and the substitution of Treasury interest rates for yield maintenance payments would likely result in cost savings to FRF. Similar to refinancing arrangements of note prepayments and write-downs, the funds necessary to finance these purchases could be obtained through Treasury borrowings. The cost savings from these options were not estimated.

The tax implications described above with respect to the effects of interest income on promissory notes are also applicable in this case. In addition, the purchase of such assets at book value could accelerate the realization of the deductions attributable to excess tax basis.

It is likely that more than $5 billion of raw land would be susceptible to such a purchase. A review of major covered assets may identify additional assets where repurchase and holding by the government could result in cost savings. The savings from such repurchases are difficult to quantify but the substitution of Treasury rates plus a maintenance cost in exchange for the existing yield maintenance rates could be likely to bring worthwhile savings.

High-yield securities. A few institutions have portfolios of non-investment grade, high yield securities ("junk bonds") on which capital loss protection has been granted but which are not covered for yield maintenance. Since these assets earn rates

higher than Treasury borrowings and FRF already bears the "credit risk" associated with these securities, DFO could consider repurchasing these assets. One contractor suggested that because RTC also has a significant portfolio of junk bonds under active management and deposition, DFO could consider having RTC manage and dispose of these assets. In the reports where specific amounts were provided there were more than $550 million of junk bonds which are candidates for such repurchase.

Participation loans. A number of institutions are involved with loans with multiple participants (participation loans), whose participations are owned by multiple acquirers controlled by FDIC, RTC and assisted institutions where the participations are similarly covered assets. In those cases there is often litigation in which the government is effectively on different and often conflicting sides. All contractors recommended that these participation loans should be consolidated and, if possible, minor participants bought out to:

- expedite resolution of the loan or foreclosure workout proceedings;
- reduce litigation costs; and
- eliminate multilayered review for multiple investments.

The litigation and administrative costs saved are not quantifiable, but could be meaningful.

RESTRUCTURING THE AGREEMENTS TO PROVIDE INCENTIVES TO STIMULATE PROMPT COVERED ASSETS DISPOSITION

Under the terms of virtually all assistance agreements, the FRF assumed most, if not all, the financial exposure associated with covered assets. Guaranteed yield and loss coverage effectively relieves the acquirer of any financial loss on a covered asset, and given the yields guaranteed in most transactions, a logical course of action for the acquirer is to hold covered assets as long as possible.

Approximately 18 months to two years into the assistance agreements the progress on covered asset disposition, as discussed earlier in this report, has been minimal in most cases. Although there are many reasons for the poor disposition results, the terms of assistance do not provide incentives to acquirers to manage assets with the objective of reducing costs and maximizing return to the government.

Structuring an effective incentive agreement requires knowledge of the portfolio to be managed and disposed of, as well as an understanding of the realities of the marketplace in which this is to occur. The actual design of such an agreement is a

difficult process that will require the interactive input of all parties so as to tune the terms to reflect their concerns and priorities. However, all contractors were in agreement that significant cost reductions in the assistance agreements are likely to be achieved by accelerating the disposition of covered assets through better incentives.

Covered assets in the transactions reviewed totaled approximately $35 billion as of year-end 1989 and future yield maintenance payments are estimated to total more than $16 billion. With this amount of exposure to FRF, one goal of any buy-out or renegotiation should be to increase the pace of covered asset disposition. The best way to accomplish this objective may well be through effective disposition incentives.

Each contractor's recommendations as they relate to improved incentive agreements are contained in their general reports included in Volume II of this report. While the specific recommendations varied, they were similar in their overall structure. Essentially each contractor recommended that incentive agreements be renegotiated to provide for both of the following fees:

- Disposition Fee. A fee predicated on proceeds from sale of a covered asset, provided the proceeds are not less than a specified percentage of current appraisal

or an independently determined value, should be remitted to the acquirer. This disposition fee should decline over time, and should be tied to the progress of disposition of the overall portfolio of covered assets.

- Gain/Loss Sharing Fee. Any proceeds in excess of current appraisal or an independently determined value should be shared with the acquirer on a declining scale over time, while proceeds less that the target value should be shared with the acquirer on an increasing scale over time.

To be effective gain/loss sharing fees must be adjusted over time to account for changing market conditions. Otherwise acquirers could be compensated for profits realized as a result of events beyond their control; likewise adverse changes in prices will cause losses they cannot control.

In return for negotiating enhanced disposition and gain/loss incentive agreements, acquirers could be willing to renegotiate yield maintenance guarantees to more closely resemble an actual cost of carry and management fee structure.

The principal incentives for renegotiation will be the ability of RTC to convince acquirers that their failure to agree

to a reasonable restructuring could cause the DFO to write down and buy back covered assets; passing the assets to professional workout groups that will have incentives for proper disposition. The ability to negotiate such restructured agreements depends very much on the terms of each agreement. An argument that favors renegotiation is that the present acquirers have already gained a substantial familiarity with the assets. Acquirers should be able to perceive that a sensible restructuring is preferable to DFO exercising its rights to write-down or buy back assets, especially if a renegotiated incentive structure will leave them in a position to earn reasonable fees for their efforts.

TAX ISSUES

A number of tax and tax related issues were addressed by the contractors. In this section four issues of primary importance are addressed. Three issues deal with the uncertainty over the tax treatment of assistance and the ability to deduct built-in losses on covered assets. The third issue concerns the use of tax benefits by corporate parents of resulting thrifts.

ASSET REPURCHASE BY DFO

As more fully explained in the General Report submitted by

the accounting firm of Price Waterhouse and the law firm of Donovan Leisure, Rogovin, Huge & Schiller, it is unclear, and subject to interpretation by both acquirers and DFO alike, what amount of gross payments from FRF constitutes assistance not included in gross income of the recipient and what amount constitutes recovery of basis. At the extreme, one might argue that a repurchase by DFO eliminates the possibility of the receipt of proceeds from a market purchaser or indicates total worthlessness. Thus, the remaining basis of the asset may be deducted as a bad debt charge-off and the entire proceeds received would represent non-taxable FRF assistance income. It appears more appropriate, however, to characterize part of the payment from FRF as a recovery of basis, at least to the extent of appraised fair market value. While this issue may not directly impact FRF, is has consequences to the Treasury in terms of tax revenues and therefore the proper treatment should be clarified by the appropriate authorities.

MARKET EARNINGS ON COVERED ASSETS

Like the previous issue, Price Waterhouse and Donovan Leisure, Rogovin, Huge & Schiller report inconsistent treatment regarding actual yield on covered assets. One interpretation effects the overstatement of tax-free assistance. Most agreements require accounting for actual yield on covered assets (generally to include rental income or loss and interest income

on low-yielding loans) through a Special Reserve Account (SRA). These items are credited to the SRA, while the gross amount of guaranteed yield is debited to the SRA. At the end of a specified period, FRF reimburses the acquired institution for any net debit balance. The acquired institution reimburses FRF any net credit balance. This may lead acquirers to take the position that actual yield represents income collected on behalf of FRF, not taxable to the acquirer. Effectively, the acquirer posits that it is functioning as agent for FRF in collecting these amounts. Guaranteed yield is considered the total amount earned on assets, and is treated as completely tax-free. Acquirers and DFO should consult with appropriate authorities to clarify that only the net difference between guaranteed yield and actual yield constitute non-taxable assistance income.

LOSSES ON COVERED ASSETS

As more fully explained in Appendix V to this report the law firm of Thacher Proffit and Wood have concluded that there is substantial doubt as to whether a widely held perception of the applicable tax law -- as allowing the realization of a tax loss when the holder of a covered asset is fully compensated for any shortfall between the amount received upon disposition and the asset's tax basis - is consistant with the applicable statutory provisions and longstanding IRS published ruling positions. They recommend that Congress and IRS review the area of the law

addressed in their legal memorandum and consider clarifying the issue as necessary.

RTC believes that such a clarification is vital. Due to the complexities of this opinion we have not tried to summarize the legal basis for their conclusion. Instead we have incorporated this opinion in its entirety for review by Congress and other appropriate authorities.

TAX SHARING ARRANGEMENTS

In some cases parent companies are apparently reimbursing their thrift subsidiaries for the share of the tax benefits owed FRF under the agreement. In other cases the parents are not. Many of the acquired associations are subsidiaries which file a consolidated federal income tax return with their parent corporation. The filing of a consolidated tax return provides a profitable group of corporations the ability to utilize current year tax operating losses of the thrift to shelter the profits of the other corporations. The tax benefit provisions of the assistance agreements recognize this when calculating the benefit which is shared by FRF. Unfortunately, the assistance agreements do not explicitly require the profitable corporations to pay the thrift for the benefit they derived by utilizing the thrift's losses. During the review of assistance agreements, situations were discovered where the parent of the consolidated tax return

group was in substance receiving a dividend from the thrift through the tax sharing agreement. A simplified example may best explain this situation.

XYZ corporation is profitable and acquires institution "A" in an FSLIC-assisted transaction. The assistance agreement provides that FSLIC will share 50 percent of any tax benefits. During the first full year after acquisition, A incurs a $100 tax loss which is used to shelter $100 of XYZ profits in a consolidated tax return. Assuming a tax rate of 34 percent, the tax benefit is $34 ($100 loss utilized x 34%) of which FRF is paid $17 by A. Thus, A has incurred a $100 tax loss tax loss and has made a payment to FRF of $17. XYZ has utilized A's $100 tax loss thereby reducing its tax liability by $34 derived in other profitable lines of business.

The consolidated federal income tax regulations provide for different methods of sharing the tax benefits and burdens incurred in consolidated tax returns. Consolidated members usually enter into an agreement regarding this sharing arrangement. However, these rules apply only for purposes of tax calculations. Members of a consolidated group are free to contract with each other regarding the actual cash payments for tax benefits and burdens between members. If one assumes in the above example that XYZ does not pay A for the utilization of A's current operating losses, there is detrimental impact on A's

equity and capital position. A paid FRF $17 and has received nothing from XYZ. Under a more equitable tax sharing agreement, XYZ would pay A for the utilization of A's [illegible]ne use of the thrift's NOL by the parent without payment is in-substance a dividend from the thrift to the parent.

FDIC, as successor to FSLIC, holds warrants in approximately six Southwest Plan thrifts that are owned by apparently profitable corporations in other lines of business. In these six transactions significant tax benefits have been or will be realized by the consolidated group. The terms of the assistance agreements call for FSLIC to share in dividends declared by the thrift. However, FDIC is not benefiting from the in-substance dividends generated by the tax sharing arrangements at these institutions.

FDIC and OTS should review the tax sharing arrangements at these and all other thrifts to insure they are consistent with sound banking practices. FDIC, as a warrant holder, should consider investigating its rights under the terms of each contract to insure that it is benefiting ratably with all other shareholders in in-substance dividends.

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OVERSIGHT AND MONITORING

The RTC contractors, without exception, recommended that the DFO's monitoring, oversight and approval procedures be modified to expedite the disposition of assets and rationalize the administrative costs for both DFO and the acquirers. The approval process was described by one contractor as "detailed and microscopic" and by another as "asset-by-asset procedural monitoring." All contractors agreed that the need for this type of asset-by-asset approval and monitoring has outlived its usefulness.

The contractors consistently recommended that the oversight and monitoring process be modified to incorporate asset disposition targets. Day-to-day monitoring should be focused on objective standards, strategic directions and management control mechanisms. The contractors recommend that individual asset plans and budgets be eliminated or restricted to assets above a prescribed value. Approval requirements should be altered to allow dispositions with no approval requirement (regardless of dollar amount) if the sale meets some predetermined objective criteria such as a set percentage of appraisal or renegotiated gain sharing benchmark. Ongoing oversight and monitoring should be concentrated on institutions where performance exceptions to the objective standards and targets are noted.

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The comments expressed are not new and the DFO has taken significant strides to improve the approval process detailed in each assistance agreement. One contractor stated "It should be noted that the [FDIC] is actively looking to improve monitoring and oversight procedures. The strategic plan of the Division of FSLIC Operations [DFO] was approved by the FDIC's Board of Directors in June [1990]. This document contains goals that coincide with many of our recommendations relating to the monitoring and oversight process."

The benefits to the FRF from improved oversight and monitoring are:

- faster response time on covered asset disposal opportunities;
- reductions in future yield maintenance payments as disposal of covered assets occurs sooner, and
- lower oversight costs.

SURVIVABILITY ISSUES

As instructed by RTC each of the contractors made a reasonable effort to evaluate the impact of their recommendations

on the survivability of each of the institutions subject to their review. Their analysis was limited to determining the effect of their recommendations could have had on 1989 reported earnings assuming cash proceeds from the prepayment of notes, the write-down of covered assets and other recommended actions was reinvested to yield net returns approximately 120 basis points more than the yield on one year U.S Treasury securities. Based on the analysis performed, if all individual recommendations were carried out to the fullest potential, significant income streams would be eliminated and such elimination would have had a detrimental impact on the viability of certain institutions. These institutions are viable now to a large extent by the level of assistance income. The ability of these institutions to remain viable depends on their success in restructuring their balance sheets and reducing operating costs.

The Office of Thrift Supervision has provided RTC with their analysis of the potential impact on the resulting institutions if DFO exercised its rights to purchase all covered assets and FSLIC promissory notes. Their analysis grouped each of the 87 institutions reviewed by them into one of seven groups based on the impact the elimination of covered assets and/or FSLIC promissory notes would have. Their analysis is summarized as follows:

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Type A -	Calling either the covered assets or the notes will likely cause the thrift to become insolvent.	11 institutions Assets of $34 Billion
Type B -	Calling the capital notes will not immediately cause the institution to fail. However, calling the covered assets will probably cause the thrift to become insolvent.	6 institutions Assets of $17 Billion
Type C -	Will probably be insolvent regardless of whether capital notes or covered assets are called.	3 institutions Assets of $1 Billion
Type D -	Calling the capital notes or covered assets will not fatally impair the viability of the thrift.	27 institutions Assets of $86 Billion
Type E -	Calling the capital notes or	6 institutions

	covered assets will help the viability of the institution.	Assets of $9 Billion
Type F -	Has no capital notes or covered assets which are subject to call.	27 institutions Assets of $34 Billion
Type G -	Thrift is already in RTC conservatorship or receivership.	7 institutions Assets of $8 Billion

While the contractors' findings do not in every case coincide with those of OTS, we agree that the magnitude of the impact on a number of institutions from excising all rights under the agreements will be severe and would potentially create nonviable institutions. This impact must be taken into consideration before certain rights are exercised.

OPTIONS FOR THE CONSIDERATION

Introduction

As discussed in the previous sections of this chapter meaningful cost savings in real present value terms can be

achieved through the exercise of unilateral rights provided in the contracts such as: (1) note prepayments; (2) asset write-downs; and (3) repurchase of selected assets. Each of these actions would have positive impacts on future tax revenues to the Treasury by reducing the amount of tax free assistance. While not so obvious, but just as important to reducing the cost of the assistance agreements, the private sector accounting and law firms, investment bankers, consultants and the public policy research group engaged by the RTC all recommended significant changes in the gain and loss sharing provisions of the existing agreements. They believe that the agreements should be modified wherever possible to properly motivate acquirers to rapidly dispose of covered assets. A buy-out or a properly structured incentive agreement operated under a system designed to adequately safe guard resources and monitor performance is ultimately the most significant change in the current process that will reduce the costs of the FSLIC Assistance Agreements.

In this report RTC, through its contractors, has raised two significant issues that need to be addressed and clarified before meaningful negotiations of the existing agreements can be undertaken in good faith. These issues concern: (1) the proper tax treatment of built-in losses on covered assets explained in Appendix V; and (2) the rights of FDIC, as a warrant holder, to fully share ratably in the tax benefits used by the corporate parents of the assisted thrifts. These issues are significant

money issues. The final prerequisite to successful renegotiations is a determination of the will of Congress to appropriate sufficient back up funds to allow RTC to negotiate from a position of strength. The amount necessary could exceed $15 billion in the fiscal year ending September 30, 1991, depending on the outcome of negotiations with the acquirers. If renegotiations fail to result in more rationally structured agreements, the FDIC or RTC would then be in a position to exercise some rather severe unilateral rights.

FSLIC PROMISSORY NOTES

The FDIC should carefully consider exercising its unilateral right to prepay the FSLIC promissory notes at the earliest opportunity whenever the interest rate terms of the notes are likely to be above short term rates of U.S Treasury securities. The FSLIC negotiated for the right to call notes and the exercise of that right cannot be construed as unfair to the acquirers. The balances on the notes have been scored for budget purposes in fiscal years 1988 and 1989. While the refinancing may cause some problems for the Treasury's fiscal operations the savings could be substantial. Including the First Gibraltar notes, the savings to the government as a whole could likely exceed $1 billion. RTC is ready to work the FDIC and Treasury to address the merits of prepayments at their earliest convenience.

The FDIC should also consider prepaying the FSLIC notes held by the institutions under FDIC and RTC control up to the level of Federal Home Loan Bank advances outstanding. While the savings from exercise of this unilateral right will not be as substantial as prepaying notes at privately owned institutions, the differential in rates available to the U.S Treasury and those paid to the Federal Home Loan Banks is significant. Because the notes held by these institutions have already been scored there will be no budgetary impact.

THE NEW WEST/AMERICAN INTERCOMPANY NOTE

The FDIC should consider continuing to direct New West FS&LA to prepay the intercompany note to the maximum extent possible. If the note is prepaid at its earliest opportunity over the next seven years the savings on this $8 billion obligation will exceed $500 million on a present value basis. To exercise its prepayment options it is likely that funds totaling approximately $1.2 billion will need to be made available to FRF in 1991. This assumes that New West has sufficient cash resources to make the approximately $780 million in prepayments allowed in 1990.

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WRITE-DOWN COVERED ASSETS TO FAIR MARKET VALUE

The contractors engaged by RTC have identified substantial savings from the exercise of the right to mark covered assets to fair market value. Assuming the option is exercised in the first calendar quarter 1991 it is estimated that potential present value savings to the government as a whole will exceed approximately $535 million. If this option is exercised to the fullest, the cash outlay from appropriated funds would approximate $3.8 billion. This action taken in isolation, or in conjunction with the prepayment of notes could cause a significant number of insolvencies. The cost of potential insolvencies will have to be evaluated further before this option is exercised on more than a very limited basis.

PURCHASE OF SELECTED COVERED ASSETS

Each contractor recommended that RTC or FDIC consider purchasing selected assets such as raw land, junk bonds and participations. In the case of raw land the yield maintenance guarantees substantially exceed expected management and efficient funding costs. In the case of junk bonds, the government has assumed the credit risk but is not benefiting from the high yields. In the case of participations the duplicate management and legal expenses plus the approvals required from each

participant have delayed disposition and raised the ultimate cost to the FDIC and RTC. The purchase of these assets should be considered.

PURCHASE OF COVERED ASSETS

Given the acquirers' knowledge of both their covered asset portfolio and market conditions, the contractors believed that if offered the proper incentives, they are in the best position to effect the most efficient resolution of their covered assets. The acquirers have a wealth of data and information about these assets developed over the past two years, and are therefore, better positioned to dispose of their covered assets than a party without this experience. Despite the knowledge developed since the assistance agreements, FDIC could potentially purchase covered assets if asset disposition targets are not met by acquirers.

REBIDDING ASSISTANCE AGREEMENTS

As an alternative to purchasing covered assets, FDIC could offer similar or different capital loss coverage and yield maintenance terms to new bidders, who would purchase the covered assets from the acquirers. Agreements with the new buyers could

be structured as an incentivized management agreement where the government finances the purchase, or if the purchaser is a financial institution with excess liquidity, as an incentivized yield maintenance and capital loss agreement. This alternative needs further study but offers the potential of having the market validate the reasonableness of the capital loss and yield maintenance coverage granted by the FSLIC.

RENEGOTIATIONS

As an alternative to relying solely on unilateral rights to buy out covered assets and prepay notes the RTC could attempt to renegotiate the existing terms of the agreements to accomplish one or more of the following objectives:

- The buying out of each of the cash and small transactions;
- Structuring workable incentive agreements focused on faster dispositions and higher prices;
- The repurchase of warrants and equity interests;
- The recapture or limitation of tax benefits;

- Lower yield maintenance fees tied to reasonable management and carrying costs; and

- Meeting the legitimate business needs of the acquirers including the avoidance of insolvency.

Conclusion

RTC looks forward to working with the Oversight Board and the Congress to establish policies for the exercise of RTC's mandate to exercise all legal rights to modify, buy out, or restructure the FSLIC Assistance Agreements where savings would be realized by such actions. In moving forward, RTC will continue to refine the cost savings estimates with its contractors and the acquirers. RTC will also confer with the IRS and the Treasury regarding possible savings resulting from different or clarification of existing tax treatment as discussed in this report.

1988 and 1989 FSLIC TRANSACTIONS SORTED BY EFFECTIVE DATE

Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
01/26/88	1721	Homebanc, FSB	Rockford	IL	First FS&LA	Freeport	IL	$24	322
02/10/88	1722	Atlantic Financial Fed-WVA, FSB	Charleston	WV	Mountain State FS&LA	Clarksburg	WV	$91	323
					Traders FS&LA	Parkersburg	WV	$71	323
					Magnet Bank, FSB	Charleston	WV	$547	323
03/03/88	1723	Great West SB, FSB	Craig	CO	First FS&LA	Craig	CO	$30	324
03/11/88	1724	Statesman Bank for Savings, FSB	Waterloo	IA	Perpetual S&LA	Waterloo	IA	$111	325
					First Federal SB	Waterloo	IA	$165	325
					First Federalad SB	W Palm Beach	FL	$120	325
					Peoples FS&LA	Waterloo	IA	$152	325
04/11/88	1725	Sterling SA	Spokane	WA	Tri-Cities S&LA	Kennewick	WA	$71	326
04/11/88	1726	Lemont SA	Lemont,	IL	Citizens S&LA	East Alton	IL	$39	327
04/12/88	1727	Home FS&LA of Upper East TN	Johnson City	TN	Valley FS&LA	Erwin	TN	$68	328
05/13/88	1794	Coastal Banc SA	Houston	TX	Colorado County FS&LA	Columbus	TX	$228	SW001
					Security S&LA	Dickinson	TX	$116	SW001
					Cameron County SA	San Benito	TX	$28	SW001
					Alliance S&LA	Houston	TX	$127	SW001
05/18/88	1795	Southwest SA	Dallas	TX	Lamar SA	Austin	TX	$1,992	SW002
					City S&LA	San Angelo	TX	$704	SW002
					Stockton SA	Dallas	TX	$841	SW002
					Briercroft SA	Austin	TX	$909	SW002
05/25/88	1728	Hansen SB, S&LA	East Brunswick	NJ	First FS&LA of Hammonton	Hammonton	NJ	$247	329
05/26/88	1730	First Federal SB of Hempstead	Hempstead	TX	Bluebonnet SA	Hempstead	TX	$24	331
05/27/88	1729	EurekaBank, FSB	San Carlos	CA	Eureka FS&LA	San Carlos	CA	$1,675	330
06/06/88	1731	Savetrust FSB	Dyersburg	TN	Frontier FSB	Dyersburg	TN	$46	332
06/21/88	1732	Ameribank FSB	Muskegon	MI	Muskegon FS&LA	Muskegon	MI	$205	333
06/22/88	1796	Merabank Texas, FSB	El Paso	TX	Brownfield FS&LA	Brownfield	TX	$43	SW003
					First Financial SA	El Paso	TX	$321	SW003
06/24/88	1733	EurekaBank, FSB	San Carlos	CA	Stanford S&LA	Palo Alto	CA	$74	334
06/24/88	1734	World S&LA of America FS&LA	Lynnwood	WA	Lynnwood S&LA	Lynnwood	WA	$24	335
07/29/88	1735	River Valley SB, FSB	Peoria	IL	Mutual S&LA	Canton	IL	$34	336
					Galva FS&LA	Galva	IL	$14	336
					Home FS&LA	Peoria	IL	$129	336
07/29/88	1736	River Valley SB	Rock Falls	IL	Republic FS&LA	South Beloit	IL	$39	337
08/02/88	1737	First FSB Northwest	Longview	WA	First FS&LA	Longview	WA	$65	338
08/10/88	1738	United Savings of America	Chicago	IL	First FS&LA of Taylorville	Taylorville	IL	$36	339

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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
08/11/88	1739	Standard Federal Bank, FSB	Chicago	IL	Capitol Federal Savings of America	Chicago	IL	$236	340
08/12/88	1740	First FS&LA of Lincoln-Iowa	Council Bluffs	IA	First Federal Bank, FSB	Shenandoah	IA	$20	341
					Western FS&LA	Council Bluffs	IA	$23	341
08/18/88	1797	American Federal Bank, FSB	Dallas	TX	Richardson S&LA	Dallas	TX	$792	SW004
					Paris S&LA	Paris	TX	$396	SW004
					Longview S&LA	Longview	TX	$149	SW004
					Ben Milam S&LA	Cameron	TX	$218	SW004
					Irving SA	Irving	TX	$81	SW004
					Skyline S&LA	Dallas	TX	$123	SW004
					Majestic SA	McKinney	TX	$284	SW004
					Southland S&LA	Longview	TX	$37	SW004
					American Banc SA	Dallas	TX	$72	SW004
					Gladewater FS&LA	Gladewater	TX	$28	SW004
					Mercury SA of Texas	Wichita Falls	TX	$404	SW004
					Commerce FS&LA	Commerce	TX	$31	SW004
08/19/88	1796	Sunbelt Savings, FSB	Irving	TX	Federated S&LA	Brady	TX	$150	SW005
					Summit SA	Dallas	TX	$203	SW005
					Western FS&LA	Dallas	TX	$1,032	SW005
					Independent American SA, FS&LA	Irving	TX	$794	SW005
					First City SA	Irving	TX	$227	SW005
					Sunbelt SA of Texas	Dallas	TX	$2,214	SW005
					Texana S&LA	Texarkana	TX	$78	SW005
					Multibanc SA	Alice	TX	$191	SW005
08/26/88	1741	Metropolitan FB of MN, FSB	Brainerd	MN	First FS&LA	Hibbing	MN	$51	342
					First FS&LA	Grand Rapids	MN	$106	342
					First FS&LA	Brainerd	MN	$93	342
08/26/88	1741	Metropolitan FB of Iowa, FSB	Mason City	IA	Pioneer FS&LA	Mason City	IA	$310	342
					Washington FS&LA	Stillwater	MN	$296	342
					Peoples S&LA	Owantonna	MN	$213	342
08/26/88	1742	Washington FS&LA	Seattle	WA	Northwest FS&LA	Boise	ID	$27	343
08/26/88	1743	Old Stone Bank of Calif, FSB	Hayward	CA	Homestate S&LA	Hayward	CA	$178	344
08/26/88	1744	Security Trust FS&LA	Oak Ridge	TN	Commerce FSB	Knoxville	TN	$39	345
08/26/88	1799	Merabank Texas, FSB	El Paso	TX	State FS&LA	Lubbock	TX	$454	SW006
08/31/88	1800	Cimarron FS&LA	Muskogee	OK	Phoenix FS&LA	Muskogee	OK	$429	SW007
					Home FS&LA	Bartlesville	OK	$176	SW007

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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
08/31/88	1601	Red River FS&LA	Lawton	OK	Home SB, FA	Lawton	OK	$250	SW009
					Peoples FS&LA	Ardmore	OK	$50	SW009
					Heritage First S&LA	Elk City	OK	$82	SW009
					First FS&LA	Elk City	OK	$114	SW009
08/31/88	1602	Chisholm FS&LA	Kingfisher	OK	Sunbelt S&LA	Watonga	OK	$49	SW010
					Kingfisher S&LA	Kingfisher	OK	$125	SW010
08/31/88	1603	Heartland FS&LA	Ponca City	OK	Frontier FS&LA	Ponca City	OK	$1,054	SW011
09/01/88	1745	Citizens FSB	Jacksonville	FL	Citizens FS&LA	Jacksonville	FL	$63	346
09/07/88	1746	First FSB	Rogers	AR	First FSB	Rogers	AR	$120	347
09/08/88	1747	United Savings of America	Chicago	IL	Fidelity FS&LA	Berwyn	IL	$40	349
09/09/88	1804	First Heights Bank, FSB	Houston	TX	Bay City FSA	Bay City	TX	$197	SW013
					Allen Pk FS&LA	Houston	TX	$180	SW013
					Heights SA	Houston	TX	$341	SW013
					Gulf Coast SA	Richmond	TX	$66	SW013
09/15/88	1748	Secor Bank, FSB	Birmingham	AL	Coosa FS&LA	Gadsden	AL	$75	350
09/16/88	1749	Washington FS&LA	Seattle	WA	Freedom FS&LA	Corvallis	OR	$315	351
09/21/88	1751	Homebanc, FSB	Rockford	IL	Loves Park FSB	Loves Park	IL	$40	353
09/23/88	1750	Western FS&LA	Marina Del Ray	CA	Bell S&LA	San Mateo	CA	$954	352
09/23/88	1752	Union FSB of Indianapolis	Indianapolis	IN	Arsenal SA, FA	Indianapolis	IN	$160	354
09/23/88	1753	Union FSB of Frankton	Frankton	IN	Frankton FS&LA	Frankton	IN	$30	355
09/23/88	1805	First Heights Bank, FSB	Houston	TX	Champion Savings	Houston	TX	$912	SW014
09/29/88	1754	Downey S&LA	Newport Beach	CA	Butterfield, S&LA, FS&LA	Santa Ana	CA	$517	356
09/30/88	1755	First Federal Bank, FSB	Vincennes	IN	United SA of Central IN	Tipton	IN	$61	357
09/30/88	1756	Ameriana SB, FSB	New Castle	IN	Citizens FS&LA	New Castle	IN	$52	358
09/30/88	1757	Tracy S&LA, FA	Tracy	CA	Adobe SB	Concord	CA	$46	359
09/30/88	1806	Guaranty FSB	Dallas	TX	Delta SA of Texas	Alvin	TX	$234	SW015
					First FS&LA of Austin	Austin	TX	$1,141	SW015
					Guaranty FS&LA of Texas	Dallas	TX	$1,920	SW015

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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
09/30/88	1807	Franklin Federal Bancorp, FSB	Austin	TX	Franklin SA	Austin	TX	$418	SW016
					Great West SB	Austin	TX	$177	SW016
					Creditbanc SA	Austin	TX	$609	SW016
10/03/88	1758	First FSB of Indiana	Merrillville	IN	Capital FS&LA	Gary	IN	$58	360
10/07/88	1759	Republic SB, FSB	Benton	KY	First FS&LA of Mayfield	Mayfield	KY	$64	361
10/14/88	1806	Amwest SA	Bryan	TX	Security FS&LA	Pampa	TX	$307	SW017
					First FS&LA of Amarillo	Amarillo	TX	$239	SW017
					Banc Home SA	Midland	TX	$647	SW017
					Olney SA	Olney	TX	$1,420	SW017
					Southwest S&LA	Abilene	TX	$307	SW017
					Heart O' Texas SA	San Saba	TX	$272	SW017
					San Angelo SA	San Angelo	TX	$167	SW017
					Odessa SA	Odessa	TX	$159	SW017
					Petroplex SA	Midland	TX	$148	SW017
					Shamrock FSB	Shamrock	TX	$114	SW017
					Southern S&LA	Brownwood	TX	$169	SW017
10/25/88	1760	New Peoples FSB	Wooster	OH	Peoples FSB	Wooster	OH	$374	362
11/02/88	1761	Crossland SB, FSB	Salt Lake City	UT	Reliance S&LA	Rahway	NJ	$67	363
11/04/88	1762	First Nationwide Bank, FSB	San Francisco	CA	Lincoln FS&LA	Westfield	NJ	$1,225	364
11/18/88	1763	Flagship FSB	San Diego	CA	Flagship FS&LA	San Diego	CA	$96	365
11/19/88	1809	Americity FSB	Dallas	TX	Tesoro S&LA	Laredo	TX	$361	SW018
11/30/88	1764	Southside SB, FSB	Lima	OH	South Side S&LA	Lima	OH	$57	366
12/12/88	1765	MidAmerica SB, FSB	Waterloo	IA	MidAmerica, SB	Waterloo	IA	$252	367
12/14/88	1766	First Western FSA of Wenatchee	East Wenatchee	WA	Eastern Washington S&LA	East Wenatchee	WA	$50	368
12/15/88	1767	Pacific First Bank, FSB	Seattle	WA	Community First FS	Vancouver	WA	$428	369
					American Home SB	Salem	OR	$387	369
12/15/88	1768	First FS&LA of Lincoln	Lincoln	NE	Rooks County FSA	Plainville	KS	$25	370
12/15/88	1774	Rocky Mountain FSB	Cheyenne	WY	Rocky Mountain FS&LA	Cheyenne	WY	$309	376
					United SB of WY, FSB	Cheyenne	WY	$222	376
12/16/88	1770	First Nationwide Bank, FSB	San Francisco	CA	First Dearborn, FA	Dearborn	MI	$180	372
					Bloomfield S&LA, FA	Birmingham	MI	$677	372
12/17/88	1769	World S&LA of Ohio, FS&LA	Steubenville	OH	First Border SB	Piqua	OH	$115	371
					Ohio Valley S&LA	Steubenville	OH	$203	371
12/22/88	1771	Citibank FSB	Chicago	IL	Glenn Ellyn S&LA	Glenn Ellyn	IL	$71	373

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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
12/22/88	1810	Bluebonnet SB, FSB	Dallas	TX	Lamesa F&SLA	Lamesa	TX	$88	SW020
					Mesquite S&LA	Mesquite	TX	$48	SW020
					Commodore SA	Dallas	TX	$824	SW020
					Interwest Savings	Fort Worth	TX	$130	SW020
					Vista Savings	Odessa	TX	$146	SW020
					Sentry Savings	Slaton	TX	$100	SW020
					Reliance Savings	Houston	TX	$42	SW020
					Metroplex FS&LA	Hurst	TX	$76	SW020
					First Western S&LA	Colorado City	TX	$85	SW020
					Mineral Wells S&LA	Mineral Wells	TX	$32	SW020
					Southern Federal Bank	Lancaster	TX	$101	SW020
					Hi-Plains S&LA	Hereford	TX	$51	SW020
					NorthPark Savings	Richardson	TX	$177	SW020
					First Federal S&LA	Big Spring	TX	$139	SW020
					Home S&LA	Lufkin	TX	$348	SW020
12/23/88	1773	Virginia FSB	Richmond	VA	Virginia FS&LA	Richmond	VA	$689	376
12/27/88	1775	Barnett Bank of SW Georgia	Columbus	GA	First FS&LA of Columbus	Columbus	GA	$266	377
12/27/88	1811	First Gibraltar Bank FSB	Houston	TX	Gibraltar SA	Houston	TX	$6,806	SW021
					First Texas Savings	Dallas	TX	$3,147	SW021
					Killeen S&LA	Killeen	TX	$191	SW021
					Homé SA	Houston	TX	$526	SW021
					Montfort SA	Dallas	TX	$1,225	SW021
12/28/88	1772	NVR SB, FSB	McLean	VA	McLean S&LA	McLean	VA	$299	374
12/28/88	1776	New West FS&LA	Stockton	CA	American Savings, FS&LA	Stockton	CA	$29,613	379
12/28/88	1781	Metropolitan FB of Iowa, FSB	Mason City	IA	First Fin. SB	Des Moines	IA	$283	384
12/28/88	1786	Superior Bank, FSB	Oak Brook Terrace	IL	Lyons Savings FS&LA	Countryside	IL	$1,530	389
12/29/88	1777	Citizens Federal Bank, FSB	Miami	FL	American SB	Springfield	IL	$902	380

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Appendix I
(continued)

Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
12/29/88	1812	Pacific Southwest Bank, FSB	Corpus Christi	TX	Bayview Federal S&LA	Corpus Christi	TX	$78	SW022
					First Federal S&LA	Luling	TX	$31	SW022
					Independence S&LA	Gonzalez	TX	$66	SW022
					Yoakum FS&LA	Yoakum	TX	$46	SW022
					Keystone S&LA	Lampasas	TX	$36	SW022
					Charter S&LA	Corpus Christi	TX	$541	SW022
					Union S&LA	Goliad	TX	$90	SW022
					Seguin SA	Seguin	TX	$166	SW022
12/29/88	1813	Texas Trust SB, FSB	Horseshoe Bay	TX	Peoples S&LA	Llano	TX	$279	SW023
					Ranchers SA	Johnson City	TX	$109	SW023
					Burnet S&LA	Burnet	TX	$31	SW023
					Lee SA	Giddings	TX	$78	SW023
12/29/88	1814	Local America Bank of Tulsa, FSB	Tulsa	OK	Community FS&LA	Tulsa	OK	$536	SW024
12/30/88	1778	Jackson County, FS&LA	Medford	OR	Jackson County FS&LA	Medford	OR	$271	381
12/30/88	1779	Northwest FSB	Spencer	IA	Northwest FS&LA	Spencer	IA	$142	382
					Home FS&LA	Spencer	IA	$46	382
12/30/88	1780	Cardinal FSB	Cleveland	OH	Cardinal FSB	Cleveland	OH	$1,652	383
12/30/88	1780	Columbia FS&LA	Denver	CO	Columbia Savings	Denver	CO	$5,398	383
12/30/88	1780	Pathway Financial, FA	Chicago	IL	Pathway Financial, FA	Chicago	IL	$1,316	383
12/30/88	1782	Western FSB of Montana	Missoula	MT	Great Falls FS&LA	Great Falls	MT	$119	385
12/30/88	1783	Home FS&LA	San Diego	CA	Columbus S&LA	San Rafael	CA	$228	386
					Cal America S&LA, FS&LA	Walnut Creek	CA	$188	386
					First Security, F&SLA	Pleasant Hill	CA	$162	386
12/30/88	1784	Southeast Bank, NA	Miami	FL	South Florida Savings	Davie	FL	$128	387
12/30/88	1785	Beach FS&LA	Boynton Beach	FL	Beach FS&LA	Boynton Beach	FL	$1,100	388
12/30/88	1787	First Network SB	Los Angeles	CA	Tahoe S&LA, a FS&LA	South Lake Tahoe	CA	$48	390
12/30/88	1815	United SA of Texas, FSB	Houston	TX	United SA of Texas	Houston	TX	$4,521	SW025
12/30/88	1816	Equity Bank for Savings, FA	Oklahoma City	OK	Arrowhead FS&LA	Oklahoma City	OK	$276	SW026
12/31/88	1788	River Valley SB, FSB	Peoria	IL	Peoria S&LA	Peoria	IL	$177	391
12/31/88	1789	Calif Fedl Bank - Broward, FSB	Ft. Lauderdale	FL	Broward FS&LA	Fort Lauderdale	FL	$550	392
12/31/88	1790	Beverly Hills FSB	Laguna	CA	Beverly Hills Savings, FS&LA	Beverly Hills	CA	$1,310	393
12/31/88	1791	Home FS&LA	Sioux Falls	SD	United FS&LA	Aberdeen	SD	$92	394
02/03/89	1792	First Cook BK for Savings	Chicago	IL	Cook County FS&LA	Chicago	IL	$195	395
					First American S&LA	Oak Brook	IL	$29	395
04/13/89	1793	First Florida SB, FSB	Miami	FL	Tropical FS&LA	Miami	FL	$63	396

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
09/15/88	1748	Secor Bank, FSB	Birmingham	AL	Coosa FS&LA	Gadsden	AL	$75	350
		ALABAMA							
09/07/88	1746	First FSB	Rogers	AR	First FSB	Rogers	AR	$120	347
		ARKANSAS							
08/26/88	1743	Old Stone Bank of Calif, FSB	Hayward	CA	Homestate S&LA	Hayward	CA	$178	344
12/31/88	1790	Beverly Hills FSB	Laguna	CA	Beverly Hills Savings, a FS&LA	Beverly Hills	CA	$1,310	393
12/30/88	1787	First Network SB	Los Angeles	CA	Tahoe S&LA, a FS&LA	South Lake Tahoe	CA	$48	390
09/23/88	1750	Western FS&LA	Marina Del Ray	CA	Bell S&LA	San Mateo	CA	$954	352
09/29/88	1754	Downey S&LA	Newport Beach	CA	Butterfield, S&LA, FS&LA	Santa Ana	CA	$517	356
05/27/88	1729	EurekaBank, FSB	San Carlos	CA	Eureka FS&LA	San Carlos	CA	$1,675	330
08/24/88	1733	EurekaBank, FSB	San Carlos	CA	Stanford S&LA	Palo Alto	CA	$74	334
11/18/88	1763	Flagship FSB	San Diego	CA	Flagship FS&LA	San Diego	CA	$98	365
12/30/88	1783	Home FS&LA	San Diego	CA	Columbus S&LA	San Rafael	CA	$226	386
					Cal America S&LA, a FS&LA	Walnut Creek	CA	$166	386
					First Security a FS&LA	Pleasant Hill	CA	$162	386
11/04/88	1762	First Nationwide Bank, FSB	San Francisco	CA	Lincoln FS&LA	Westfield	NJ	$1,225	364
12/16/88	1770	First Nationwide Bank, FSB	San Francisco	CA	First Dearborn, FA	Dearborn	MI	$180	372
					Bloomfield S&LA, FA	Birmingham	MI	$677	372
12/28/88	1778	New West FS&LA	Stockton	CA	American Savings, a FS&LA	Stockton	CA	$29,613	379
09/30/88	1757	Tracy S&LA, FA	Tracy	CA	Adobe SB	Concord	CA	$46	359
		CALIFORNIA							

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
(continued)

Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
03/03/88	1723	Great West Savings Bank, FSB	Craig	CO	First FS&LA	Craig	CO	$30	324
12/30/88	1780	Columbia FS&LA	Denver	CO	Columbia Savings	Denver	CO	$5,396	363
	2	COLORADO							
12/30/88	1785	Beach FS&LA	Boynton Beach	FL	Beach FS&LA	Boynton Beach	FL	$1,100	358
12/31/88	1789	Calif Fedl Bank - Broward, FSB	Ft. Lauderdale	FL	Broward FS&LA	Fort Lauderdale	FL	$550	392
09/01/88	1745	Citizens FSB	Jacksonville	FL	Citizens FS&LA	Jacksonville	FL	$63	346
04/13/89	1793	First Florida SB, FSB	Miami	FL	Tropical FS&LA	Miami	FL	$83	396
12/30/88	1784	Southeast Bank, NA	Miami	FL	South Florida Savings	Davie	FL	$128	387
12/29/88	1777	Citizens Federal Bank, FSB	Miami	FL	American SB	Springfield	IL	$902	360
	6	FLORIDA							
12/27/88	1778	Barnett Bank of SW Georgia	Columbus	GA	First FS&LA of Columbus	Columbus	GA	$266	377
	1	GEORGIA							
06/12/88	1740	First FS&LA of Lincoln-Iowa	Council Bluffs	IA	Western FS&LA	Council Bluffs	IA	$23	341
					First Federal Bank, FSB	Shenandoah	IA	$20	341
06/26/88	1741	Metropolitan FB of Iowa, FSB	Mason City	IA	Pioneer FS&LA	Mason City	IA	$310	342
					Peoples S&LA	Owantonna	MN	$213	342
					Washington FS&LA	Stillwater	MN	$298	342
12/26/88	1761	Metropolitan FB of Iowa, FSB	Mason City	IA	First Fin. SB	Des Moines	IA	$263	364
12/30/88	1779	Northwest FSB	Spencer	IA	Home FS&LA	Spencer	IA	$46	362
					Northwest FS&LA	Spencer	IA	$142	362
03/11/88	1724	Statesman Bank for Savings, FSB	Waterloo	IA	First Federated SB	W Palm Beach	FL	$120	325
					Perpetual S&LA	Waterloo	IA	$111	325
					First Federal SB	Waterloo	IA	$165	325
					Peoples FS&LA	Waterloo	IA	$152	325
12/12/88	1765	MidAmerica SB, FSB	Waterloo	IA	MidAmerica, SB	Waterloo	IA	$252	367
	8	IOWA							

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
12/22/88	1771	Citibank FSB	Chicago	IL	Glenn Ellyn S&LA	Glenn Ellyn	IL	$71	373
02/03/89	1792	First Cook BK for Savings	Chicago	IL	Cook County FS&LA	Chicago	IL	$196	395
					First American S&LA	Oak Brook	IL	$29	395
12/30/88	1780	Pathway Financial, FA	Chicago	IL	Pathway Financial, FA	Chicago	IL	$1,316	383
09/11/88	1739	Standard Federal Bank, FSB	Chicago	IL	Capitol Federal Savings of America	Chicago	IL	$236	340
09/08/88	1747	United Savings of America	Chicago	IL	Fidelity FS&LA	Berwyn	IL	$40	349
09/10/88	1736	United Savings of America	Chicago	IL	First FS&LA of Taylorville	Taylorville	IL	$36	339
04/11/88	1726	Lemont SA	Lemont,	IL	Citizens S&LA	East Alton	IL	$39	327
12/28/88	1786	Superior Bank, FSB	Oak Brook Terrace	IL	Lyons Savings FS&LA	Countryside	IL	$1,530	389
07/29/88	1735	River Valley SB, FSB	Peoria	IL	Mutual S&LA	Canton	IL	$34	336
					Galva FS&LA	Galva	IL	$14	336
					Home FS&LA	Peoria	IL	$129	336
12/31/88	1788	River Valley SB, FSB	Peoria	IL	Peoria S&LA	Peoria	IL	$177	391
07/29/88	1736	River Valley SB	Rock Falls	IL	Republic FS&LA	South Beloit	IL	$39	337
09/21/88	1751	Homebanc, FSB	Rockford	IL	Lovee Park FSB	Lovee Park	IL	$40	353
01/26/88	1721	Homebanc, FSB	Rockford	IL	First FS&LA	Freeport	IL	$24	322
	10	ILLINOIS							
09/23/88	1753	Union FSB of Frankton	Frankton	IN	Frankton FS&LA	Frankton	IN	$30	355
09/23/88	1752	Union FSB of Indianapolis	Indianapolis	IN	Arsenal SA, FA	Indianapolis	IN	$160	354
10/03/88	1758	First FSB of Indiana	Merrillville	IN	Capital FS&LA	Gary	IN	$56	360
09/30/88	1756	Ameriana SB, FSB	New Castle	IN	Citizens FS&LA	New Castle	IN	$52	358
09/30/88	1755	First Federal Bank, a FSB	Vincennes	IN	United SA of Central IN	Tipton	IN	$61	357
	5	INDIANA							
10/07/88	1759	Republic SB, FSB	Benton	KY	First FS&LA of Mayfield	Mayfield	KY	$64	361
	1	KENTUCKY							
09/21/88	1732	Ameribank FSB	Muskegon	MI	Muskegon FS&LA	Muskegon	MI	$205	333
	1	MICHIGAN							

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
08/26/88	1741	Metropolitan FB of MN, FSB	Brainerd	MN	First FS&LA	Hibbing	MN	$51	342
					First FS&LA	Brainerd	MN	$93	342
					First FS&LA	Grand Rapids	MN	$105	342
	1	MINNESOTA							
12/30/88	1782	Western FSB of Montana	Missoula	MT	Great Falls FS&LA	Great Falls	MT	$119	365
	1	MONTANA							
12/15/88	1768	First FS&LA of Lincoln	Lincoln	NE	Rooks County FSA	Plainville	KS	$25	370
	1	NEBRASKA							
05/25/88	1726	Hansen SB, S&LA	East Brunswick	NJ	First FS&LA of Hammonton	Hammonton	NJ	$247	329
	1	NEW JERSEY							
12/30/88	1780	Cardinal FSB	Cleveland	OH	Cardinal Federal SB	Cleveland	OH	$1,052	363
11/30/88	1764	Southside SB, FSB	Lima	OH	South Side S&LA	Lima	OH	$57	366
12/17/88	1769	World S&LA of Ohio, FS&LA	Steubenville	OH	Ohio Valley S&LA	Steubenville	OH	$203	371
					First Border SB	Piqua	OH	$116	371
10/25/88	1760	New Peoples FSB	Wooster	OH	Peoples FSB	Wooster	OH	$374	362
	4	OHIO							

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
08/31/88	1802	Chisholm FS&LA	Kingfisher	OK	Kingfisher S&LA	Kingfisher	OK	$125	SW010
					Sunbelt S&LA	Watonga	OK	$49	SW010
08/31/88	1801	Red River FS&LA	Lawton	OK	Peoples FS&LA	Ardmore	OK	$50	SW009
					Home SB, FA	Lawton	OK	$250	SW009
					Heritage First S&LA	Elk City	OK	$82	SW009
					First FS&LA	Elk City	OK	$114	SW009
08/31/88	1800	Cimarron FS&LA	Muskogee	OK	Phoenix FS&LA	Muskogee	OK	$429	SW007
					Home FS&LA	Bartlesville	OK	$176	SW007
12/30/88	1816	Equity Bank for Savings, FA	Oklahoma City	OK	Arrowhead FS&LA	Oklahoma City	OK	$276	SW026
09/31/88	1803	Heartland FS&LA	Ponca City	OK	Frontier FS&LA	Ponca City	OK	$1,054	SW011
12/29/88	1814	Local America Bank of Tulsa, FSB	Tulsa	OK	Community FS&LA	Tulsa	OK	$539	SW024
1 OKLAHOMA									
12/30/88	1778	Jackson County, FS&LA	Medford	OR	Jackson County FS&LA	Medford	OR	$271	381
1 OREGON									
12/31/88	1791	Home FS&LA	Sioux Falls	SD	United Federal S&LA	Aberdeen	SD	$92	394
1 SOUTH DAKOTA									
06/06/88	1731	Savetrust FSB	Dyersburg	TN	Frontier FSB	Dyersburg	TN	$48	332
04/12/88	1727	Home FS&LA of Upper East TN	Johnson City	TN	Valley FS&LA	Erwin	TN	$88	328
08/26/88	1744	Security Trust FS&LA	Oak Ridge	TN	Commerce FSB	Knoxville	TN	$39	345
3 TENNESSEE									

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
09/30/88	1807	Franklin Federal Bancorp, FSB	Austin	TX	Creditbanc SA	Austin	TX	$609	SW016
					Great West SB	Austin	TX	$177	SW016
					Franklin SA	Austin	TX	$418	SW016
10/14/88	1808	Amwest SA	Bryan	TX	Banc Home SA	Midland	TX	$647	SW017
					Olney SA	Olney	TX	$1,420	SW017
					Security FS&LA	Pampa	TX	$397	SW017
					San Angelo SA	San Angelo	TX	$167	SW017
					Shamrock FSB	Shamrock	TX	$114	SW017
					Petroplex SA	Midland	TX	$148	SW017
					Odessa SA	Odessa	TX	$159	SW017
					Heart O' Texas SA	San Saba	TX	$272	SW017
					First FS&LA of Amarillo	Amarillo	TX	$239	SW017
					Southern S&LA	Brownwood	TX	$169	SW017
					Southwest S&LA	Abilene	TX	$307	SW017
12/29/88	1812	Pacific Southwest Bank, FSB	Corpus Christi	TX	First Federal S&LA	Luling	TX	$31	SW022
					Independence S&LA	Gonzalez	TX	$66	SW022
					Charter S&LA	Corpus Christi	TX	$541	SW022
					Union S&LA	Goliad	TX	$90	SW022
					Bayview Federal S&LA	Corpus Christi	TX	$78	SW022
					Seguin SA	Seguin	TX	$156	SW022
					Keystone S&LA	Lampasas	TX	$38	SW022
					Yoakum FS&LA	Yoakum	TX	$46	SW022
08/18/88	1797	American Federal Bank, FSB	Dallas	TX	American Banc SA	Dallas	TX	$72	SW004
					Gladewater FS&LA	Gladewater	TX	$28	SW004
					Southland S&LA	Longview	TX	$37	SW004
					Ben Milam S&LA	Cameron	TX	$218	SW004
					Mercury SA of Texas	Wichita Falls	TX	$404	SW004
					Irving SA	Irving	TX	$81	SW004
					Commerce FS&LA	Commerce	TX	$31	SW004
					Paris S&LA	Paris	TX	$396	SW004
					Skyline S&LA	Dallas	TX	$123	SW004
					Majestic SA	McKinney	TX	$264	SW004
					Richardson S&LA	Dallas	TX	$792	SW004
					Longview S&LA	Longview	TX	$149	SW004
11/19/88	1809	Americity FSB	Dallas	TX	Tesoro S&LA	Laredo	TX	$361	SW018

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
12/22/88	1810	Bluebonnet SB, FSB	Dallas	TX	NorthPark Savings	Richardson	TX	$177	SW020
					Commodore SA	Dallas	TX	$824	SW020
					Interwest Savings	Fort Worth	TX	$130	SW020
					First Western S&LA	Colorado City	TX	$85	SW020
					Metroplex FS&LA	Hurst	TX	$76	SW020
					First Federal S&LA	Big Spring	TX	$139	SW020
					Mineral Wells S&LA	Mineral Wells	TX	$32	SW020
					Lamesa F&SLA	Lamesa	TX	$66	SW020
					Hi-Plains S&LA	Hereford	TX	$51	SW020
					Mesquite S&LA	Mesquite	TX	$46	SW020
					Home S&LA	Lufkin	TX	$348	SW020
					Sentry Savings	Slaton	TX	$109	SW020
					Reliance S&LA	Houston	TX	$42	SW020
					Southern Federal Bank	Lancaster	TX	$101	SW020
					Vista Savings	Odessa	TX	$146	SW020
09/30/88	1806	Guaranty FSB	Dallas	TX	Guaranty FS&LA of Texas	Dallas	TX	$1,920	SW015
					First FS&LA of Austin	Austin	TX	$1,141	SW015
					Delta SA of Texas	Alvin	TX	$234	SW015
05/18/88	1795	Southwest SA	Dallas	TX	Briercroft SA	Austin	TX	$909	SW002
					Stockton SA	Dallas	TX	$841	SW003
					City S&LA	San Angelo	TX	$704	SW002
					Lamar SA	Austin	TX	$1,992	SW002
08/26/88	1799	Mesabank Texas, FSB	El Paso	TX	State FS&LA	Lubbock	TX	$454	SW006
08/22/88	1796	Mesabank Texas, FSB	El Paso	TX	First Financial SA	El Paso	TX	$321	SW003
					Brownfield FS&LA	Brownfield	TX	$43	SW003
05/26/88	1730	First FSB of Hempstead	Hempstead	TX	Bluebonnet SA	Hempstead	TX	$24	331
12/29/88	1813	Texas Trust SB, FSB	Horseshoe Bay	TX	Burnet S&LA	Burnet	TX	$31	SW023
					Lee SA	Giddings	TX	$78	SW023
					Peoples S&LA	Llano	TX	$279	SW023
					Ranchers SA	Johnson City	TX	$109	SW023
05/15/88	1794	Coastal Banc SA	Houston	TX	Alliance S&LA	Houston	TX	$127	SW001
					Security S&LA	Dickinson	TX	$116	SW001
					Colorado County FS&LA	Columbus	TX	$226	SW001
					Cameron County SA	San Benito	TX	$26	SW001

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
12/27/88	1811	First Gibraltar Bank FSB	Houston	TX	First Texas Savings	Dallas	TX	$3,147	SW021
					Killeen S&LA	Killeen	TX	$191	SW021
					Gibraltar SA	Houston	TX	$6,696	SW021
					Home SA	Houston	TX	$528	SW021
					Montfort SA	Dallas	TX	$1,225	SW021
09/23/88	1805	First Heights Bank, FSB	Houston	TX	Champion Savings	Houston	TX	$912	SW014
09/09/88	1804	First Heights Bank, FSB	Houston	TX	Heights SA	Houston	TX	$341	SW013
					Gulf Coast SA	Richmond	TX	$66	SW013
					Bay City FS&LA	Bay City	TX	$107	SW013
					Allen Pk FS&LA	Houston	TX	$180	SW013
12/30/88	1815	United SA of Texas, FSB	Houston	TX	United SA of Texas	Houston	TX	$4,521	SW025
09/19/88	1796	Sunbelt Savings, FSB	Irving	TX	Texana S&LA	Texarkana	TX	$75	SW005
					Federated S&LA	Brady	TX	$150	SW005
					Multibanc SA	Alice	TX	$191	SW005
					Summit SA	Dallas	TX	$203	SW005
					Independent American SA, FS&LA	Irving	TX	$794	SW005
					Sunbelt SA of Texas	Dallas	TX	$2,214	SW005
					Western FS&LA	Dallas	TX	$1,032	SW005
					First City SA	Irving	TX	$227	SW005
	10	TEXAS							
11/02/88	1761	Crossland SB, FSB	Salt Lake City	UT	Reliance S&LA	Rahway	NJ	$67	363
	1	UTAH							
12/23/88	1773	Virginia FSB	Richmond	VA	Virginia FS&LA	Richmond	VA	$689	375
12/28/88	1772	NVR SB, FSB	McLean	VA	McLean S&LA	McLean	VA	$299	374
	2	VIRGINIA							

1988 and 1989 FSLIC TRANSACTIONS SORTED BY STATE OF ENTITY RECEIVING ASSISTANCE

Appendix II
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Effective Date	FDIC Case Number	Resulting Entity (Current Name)	Location		Acquired Association	Location		Assets ($ Millions)	FSLIC Case No.
12/14/88	1766	First Western FSA of Wenatchee	East Wenatchee	WA	Eastern Washington S&LA	East Wenatchee	WA	$50	368
06/02/88	1737	First FSB Northwest	Longview	WA	First FS&LA	Longview	WA	$85	336
06/24/88	1734	World S&LA of America FS&LA	Lynnwood	WA	Lynnwood S&LA	Lynnwood	WA	$24	335
12/15/88	1767	Pacific First Bank, FSB	Seattle	WA	American Home SB	Salem	OR	$367	369
					Community First FS	Vancouver	WA	$428	369
09/16/88	1749	Washington FS&LA	Seattle	WA	Freedom FS&LA	Corvallis	OR	$315	351
					Northwest FS&LA	Boise	ID	$27	343
04/11/88	1725	Sterling SA	Spokane	WA	Tri-Cities S&LA	Kennewick	WA	$71	326
6 WASHINGTON									
02/10/88	1722	Atlantic Financial Fed-WVA, FSB	Charleston	WV	Traders FS&LA	Parkersburg	WV	$71	323
					Mountain State FS&LA	Clarksburg	WV	91	323
					Magnet Bank, FSB	Charleston	WV	647	323
1 WEST VIRGINIA									
12/15/88	1774	Rocky Mountain FSB	Cheyenne	WY	Rocky Mountain FS&LA	Cheyenne	WY	$309	378
					United Savings Bank of WY, FSB	Cheyenne	WY	$222	378
1 WYOMING									

APPENDIX III

THE COST ESTIMATION ("MODELING") PROCESS

The variety of assisted transactions in 1988 and 1989 required considerable flexibility in the models used to estimate the costs of the transactions. This was accomplished primarily by creating models that were easily customized as required. The primary models were: (a) the FSLIC costing model for capital loss and yield maintenance, (b) a lotus model developed by Coopers and Lybrand for other types of assistance, and (c) a lotus model developed by Kenneth Leventhal and Company for tax calculations. The major assumptions were determined prior to any modeling efforts so that all contractors (and all models) could use the same assumptions. All models were validated by the contractors prior to being used for this review.[1]

Contractors were required to model the assistance agreement as it is currently being executed to provide an estimate of the cost to the FSLIC Resolution Fund (FRF). Recommendations, however, were required to be modeled to provide estimates of cost savings to the FRF and the Federal government as a whole. When estimating the savings from implementing recommendations, the contractors did not

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[1] Because the American Savings, FS & LA transaction, reviewed by the Mid-America Institute for Public Policy Research, was so different from all other transactions, its costs were estimated using a model specifically created for that transaction. Interest rate scenarios and discount rates used in the American Savings, FS & LA transaction were similar to those used in the other 95 transactions reviewed.

explicitly model the financing mechanisms that might be needed to implement the recommendations. Instead, financing costs were implicitly considered by using the present value costs to calculate the savings generated.

All calculations used the same basic methodology of estimating the cash flows and discounting them to arrive at the estimated present value cost. The cash flows were normally modeled on a quarterly basis; however, semi-annual and annual cash flows were used in some cases -- particularly when the required input data were not available quarterly. This was normally the case for tax information, so most tax modeling was done annually. All aspects of each transaction were modeled when significant cash flows to or from the FRF were expected.

The discount rate used was 8.32%, compounded quarterly. If semi-annual or annual modeling was used, then the discount rate was 8.40% or 8.58%, respectively.[2] This was the average one year Treasury rate for May 1990. The Treasury rate was deemed appropriate because Treasury borrowing for refinancing of these transactions appears to be the most likely alternative. The one year term was chosen because it was similar to the short term adjustable rates of the obligations that would most likely be

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[2] After compounding, all three rates produce an annual yield of 8.58%.

refinanced. The month of May was the most recent month for which complete data were available when the modeling began.

The interest rate scenario was also based on May data. A constant scenario was assumed (i.e., rates did not change over the simulation period). A few of the key rates are shown below.

Table 1

Description	Rate
Three Month Treasury Bill	7.74%
One Year Treasury Note	8.32%
Three Year Treasury Note	8.69%
Five Year Treasury Note	8.74%
Ten Year Treasury Bond	8.76%
Conventional Fixed-Rate Mort.	9.83%
One Year LIBOR	8.63%

In addition to rates for specific instruments, rates were assigned for certain cost of fund (COF) indices that were used in the assistance agreement calculations. These rates were developed after studying the relationships between the various COF indices and the one year Treasury yield. Trends in the historical spreads between these indices and the Treasury rate were considered, as well as the natural lag that occurs between COFs and short-term Treasuries. Table 2 provides information about the historical rates for the one-year Treasury and several COFs used in the 88 transactions. These rates are shown graphically in Figure 1.

Table 2

One Year U.S. Treasury Yields and COF's of Selected Districts and the State of Texas***

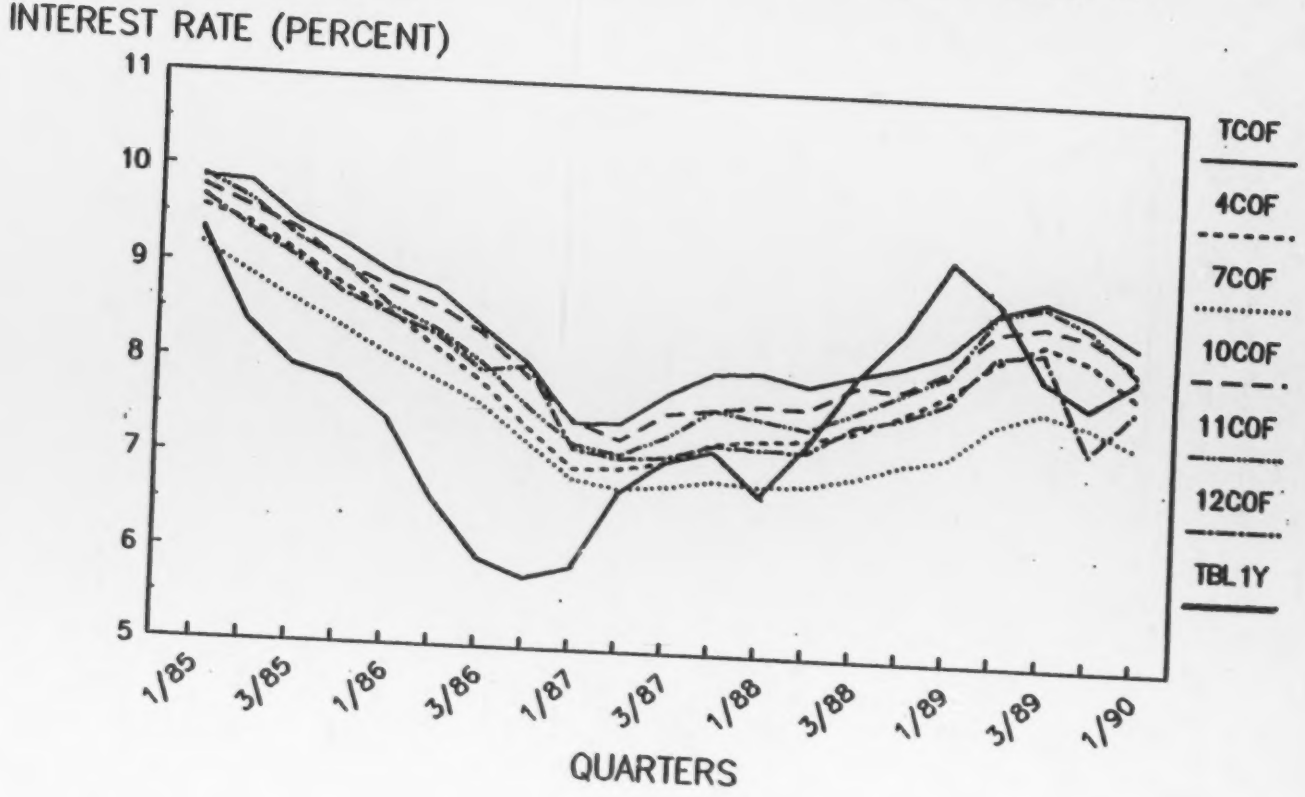
QUARTER	UST1Y	TCOF	4COF	7COF	10COF	11COF	12COF
1/85	9.33	9.88	9.58	9.19	9.79	9.90	9.68
2/85	8.39	9.85	9.41	8.90	9.58	9.66	9.35
3/85	7.94	9.46	9.12	8.62	9.36	9.28	9.07
4/85	7.81	9.24	8.80	8.37	9.01	9.03	8.72
1/86	7.41	8.95	8.53	8.08	8.79	8.60	8.50
2/86	6.57	8.79	8.17	7.85	8.61	8.37	8.31
3/86	5.96	8.40	7.84	7.61	8.34	8.04	7.95
4/86	5.77	8.03	7.38	7.22	7.90	7.60	8.02
1/87	5.90	7.45	6.96	6.84	7.47	7.22	7.16
2/87	6.72	7.46	6.97	6.76	7.28	7.12	7.08
3/87	7.06	7.79	7.06	6.80	7.58	7.33	7.11
4/87	7.20	8.01	7.28	6.88	7.64	7.64	7.26
1/88	6.74	8.03	7.33	6.84	7.70	7.56	7.24
2/88	7.30	7.92	7.35	6.87	7.69	7.48	7.23
3/88	8.01	8.05	7.47	6.97	7.93	7.67	7.53
4/88	8.52	8.16	7.67	7.12	7.92	7.89	7.63
1/89	9.29	8.33	7.90	7.22	8.14	8.09	7.82
2/89	8.90	8.78	8.25	7.59	8.56	8.75	8.32
3/89	8.09	8.92	8.46	7.76	8.65	8.86	8.37
4/89	7.81	8.75	8.29	7.62	8.54	8.63	7.34
1/90	8.11	8.46	7.94	7.41	8.26	8.19	7.81
AVG	7.56	8.51	7.99	7.55	8.32	8.23	7.98

*Yields on one year U.S. Treasury Securities adjusted to a constant maturity as published by the Federal Reserve Board.

**Weighted average cost of interest bearing liabilities as published by the Federal Home Loan Bank Board and the Office of Thrift Supervision.

Figure 1

ONE YEAR T-BILL VS. SELECTED COF'S



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The spreads, in basis points, between the two most frequently used COF indicies over the one year Treasury rate are shown below.

Table 3

Quarterly Period Ending	Texas COF	San Fran. District COF
3/90	80 bp	85 bp
6/90	85 bp	90 bp
9/90	80 bp	85 bp
12/90	77 bp	83 bp
3/91	75 bp	80 bp
6/91	75 bp	80 bp
9/91	70 bp	77 bp
12/91 & beyond	65 bp	75 bp

Note that these are the spreads between the indices and the one year Treasury rate (8.32%) -- not the national average COF.[3] Thus the Texas COF ranges from 8.97% to 9.17% and the San Francisco (11th) District COF ranges from 9.07% to 9.22%. Another rate that was used extensively in the analysis was the assumed reinvestment rate for funds that would be received by resulting institutions if notes were prepaid or capital losses were recognized. This was assumed to be 9.5%, which represents a blend of security and mortgage rates that might be considered typical for a conservative thrift institution.

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[3] The spreads between these indices and the national COF would be somewhat lower.

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There were a few problems with the differentiation between periodic rates and annual yields in the interest rate scenario. The Treasury rates shown above are actually annual yields; however, most calculations were performed assuming that they were quarterly rates. This effectively increased the Treasury yields by as much as 29 basis points. There were similar problems with the treatment of the rates used for FSLIC Notes and yield maintenance due to differences in the treatment of compounding in the assistance agreements and the modeling. An analysis of these problems was conducted when they were discovered, and it showed that the calculation problems caused an error of less than 5% when calculating costs typical of these assistance agreements.

The primary assumptions for capital loss coverage and yield maintenance are the loss rates and yields for the covered assets and the disposition rates. If the acquirer intended to write down any of these assets prior to disposition, this could also have a profound effect on the estimated cost of assistance. The contractors investigated all available sources for this information, but did not perform an audit or extensive due diligence. The best source was almost always the acquirer (since the acquirer was actually working the asset). The contractors did not accept the acquirer's estimates, however, in cases where they seemed unreasonable given the contract incentives, asset characteristics and prior experience. If this occurred, the contractors developed their own estimates based on the available

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information. All cash flows from the underlying assets were recorded net of direct expenses (except those expenses paid directly by FRF per the assistance agreement). Prepayment rates for performing assets were estimated based on the type of loan and the difference between market rates and the coupon rates of the covered assets.

The information about FSLIC Notes was culled from the assistance agreement and the results of post-transaction audits.

The value of preferred stock and warrants was generally estimated based on the percentage of ownership represented at the resolution date. The values were not updated using more current data because the FDIC Division of FSLIC Operations has engaged the services of an investment banking firm to value the warrants and other capital instruments and assist them in ongoing negotiations with acquirers wishing to cancel these instruments. Because of the potential return on the warrants received in the American Savings, FS & LA transaction, extensive analysis and modeling was performed in order to estimate the value of those warrants.

The tax effects of these transactions varied widely, as did the availability of information for estimating tax consequences. Some acquirers were quite helpful in providing tax information; others provided nothing. If taxable income was not available, book income of the resultant thrift less FRF payments was used as a

proxy for taxable income. Because of the uniqueness of each acquirer's tax position, the tax model was customized for most transactions. However, certain key assumptions were maintained throughout. First, where practicable the contractors were required to model each recommendation from the perspective of the FRF and for the government as a whole. The same discount rates and interest rates were assumed as discussed above. The appropriate marginal tax rate for the entity type was used (31.2% at the thrift level and 34% at the corporate level), and alternative minimum taxes were considered. The contractors assumed that the acquirers would use the tax benefits in the most profitable manner available. Unlike the other aspects of the assistance agreement, contractors were required to model tax benefits beyond the term of the assistance agreement when the tax benefits accruing to the FRF exceeded five percent of the total cost of assistance.

When modeling recommendations that required the FDIC to purchase assets from the acquirers, all contractors assumed that the asset management fees would be 50 basis points per year plus a 1.5% asset disposition fee at the time of sale. These assumptions may well be too low to induce proper management and rapid resolution of problem assets. However, as explained in Chapter IV RTC is not recommending the purchase of any assets without further investigation and cost benefit analysis.

Other FRF cash flows were also modeled according to the general guidelines above.

In addition to estimating the savings to the FRF and the government as a whole related to the recommendations, contractors were instructed to provide an analysis of the viability of the surviving institution both before and after the recommended changes to the assistance agreement. This was performed by examining the financial statements of the thrift and the likely effects of the recommendations on the thrifts' financial statements. These analyses are fairly general, but provide sufficient information to trigger more in-depth analysis as needed in the future.

Note that many of the major assumptions are subject to considerable uncertainty in the future. These include the interest rate scenario, asset disposition rates, asset loss rates and the future tax position of the institutions. To partially capture the effects of the uncertainty, the contractors performed three types of sensitivity analysis on their recommendations: (a) interest rate, (b) disposition rate, and (c) capital loss rate. The interest rate sensitivity was performed by assuming four "shocks" to the base case interest rate scenario; these were reductions on 125 and 250 basis points and increases of 125 and 250 basis points. The disposition rate sensitivity was performed by altering the most likely scenario in two ways; by increasing the speed of asset sales

by one year[4] and by decreasing the speed of asset sales by one year[5]. The capital loss sensitivity was performed by assuming loss rates 15% higher and lower than the estimate used in the base case, but not greater than 100% loss or less than 0% loss. Sensitivity analysis was performed for each recommendation except in cases where it was not applicable or material.

In the final analysis, the savings from recommendations to reduce costs made by the contractors were not very sensitive to changes in interest rates, disposition rates and capital loss rates. As is more fully discussed in Chapter IV, recommendations can best be described as financing alternatives. The savings, in relation to the existing obligations likely from such recommendations, are affected less by the amount or timing of losses than by the different costs of efficient versus inefficient funding of the Federal government's obligations.

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[4] All sales projected to occur in the first two years were assumed to occur in year one. All other sales occurred one year earlier than predicted.

[5] Assume that no sales occur in year one, and that all projections are pushed back one year.

BAKER
&
HOSTETLER
COUNSELLORS AT LAW

WASHINGTON SQUARE, SUITE 1100 • 1050 CONNECTICUT AVENUE, N.W. • WASHINGTON, D.C. 20036 • (202) 861-1500
FAX (202) 861-1783 • TELEX (88?) 2357276
WRITER'S DIRECT DIAL NUMBER (202)

MEMORANDUM

TO: Resolution Trust Corporation

FROM: Baker & Hostetler

DATE: September 10, 1990

SUBJECT: Authority of Resolution Trust Corporation to Restructure Resolution Cases

Section 501(a) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183, 373 (1989) ("FIRREA"), amended the Federal Home Loan Bank Act, 12 U.S.C. §§ 1421-1449 (1932) (the "FHLBA") by inserting a new Section 21A, which established the Oversight Board and the Resolution Trust Corporation ("RTC"). Section 21A(b)(11)(B) of the FHLBA, as amended by FIRREA, directs RTC to "review and analyze all insolvent institution cases resolved by the Federal Savings and Loan Insurance Corporation between January 1, 1988, and the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, and actively review all means by which it can reduce costs under existing Federal Savings and Loan Insurance Corporation agreements relating to such cases, including restructuring such agreements . . . ." Section 21A(b)(11)(B) further requires that "[t]he Corporation shall exercise any and all legal rights to modify, renegotiate, or restructure such agreements where savings would be realized by such actions."[1]

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[1] For convenience we have observed the following definitional conventions in this memorandum. "FIRREA" refers to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. "FHLBA" refers to the Federal Home Loan Bank Act, as amended. "RTC" refers to Resolution Trust Corporation. "FSLIC" refers to Federal Savings and Loan Insurance Corporation. "Resolution Agreements" refers to the agreements resolving insolvent institution cases entered into by FSLIC between January 1, 1988, and the date of enactment of FIRREA. "FHLBB" refers to Federal Home Loan Bank Board. "FDIC" refers to Federal Deposit Insurance Corporation. "Section 21A(b)(11)(B)" refers to the section of the FHLBA, as amended by Section 501 of FIRREA, which, among other things, provides for the review of the Resolution Agreements. Each of these terms is also defined in the text. In addition, the term "restructure" when used in connection with the Resolution Agreements is intended to encompass the concepts of modification, rescission, abrogation, and repudiation.

You have asked our opinion as to what specific "legal rights" RTC is authorized to exercise in connection with the modification, renegotiation or restructuring of the Resolution Agreements. Accordingly, we investigated whether FIRREA grants RTC new powers to abrogate or repudiate the Resolution Agreements entered into by the Federal Savings and Loan Insurance Corporation ("FSLIC") and referred to in Section 21A(b)(11)(B) quoted above. We also investigated whether FSLIC would have had the authority to restructure the Resolution Agreements.

CONCLUSION

We are of the opinion that the language of FIRREA and its legislative history clearly establish that FIRREA does not grant RTC new powers to abrogate or repudiate unilaterally existing FSLIC agreements resolving insolvent institution cases. To the extent that it is a successor to FSLIC for this purpose, RTC succeeds to the contractual rights of FSLIC under the Resolution Agreements and has the same, but unenhanced, statutory and common law rights that were available to FSLIC before enactment of FIRREA.

ANALYSIS

1. Absence of New Powers.

(a) The statute.

The starting point for any inquiry regarding the powers that Congress bestowed upon RTC must be the language employed by Congress. See Reiter v. Sonotone Corp., 442 U.S. 330, 337 (1979). See also United States v. Turkette, 452 U.S. 576, 588-93 (1981); United States v. James, 478 U.S. 597, 604-06 (1986); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 733-35 (1975); American Tobacco Co. v. Patterson, 456 U.S. 63, 68-69 (1982). A legislature's "purpose is expressed by the ordinary meanings of the words used." Richards v. United States, 369 U.S. 1, 9 (1962). Absent ambiguity in the language chosen by Congress or a clearly expressed legislative intention to the contrary, the ordinary meanings of the words used by Congress must be regarded as conclusive. See, e.g., Consumer Product Safety Comm'n v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980); United States v. Turkette, 452 U.S. 576, 593 (1981).

The language of Section 501 is clear and unambiguous. It directs RTC to: review and analyze all insolvent institution cases resolved by FSLIC between January 1, 1988 and the date of enactment of FIRREA; review all means by which it can reduce costs under existing FSLIC agreements relating to such cases; and exercise all legal rights to modify, renegotiate

or restructure such agreements where savings would be realized by such actions. It further provides:

> Nothing in this paragraph shall be construed as granting the Corporation any legal rights to modify, renegotiate, or restructure agreements between the Federal Savings and Loan Insurance Corporation and any other party, which did not exist prior to the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

FIRREA, 103 Stat. 373.

Thus, by its express terms FIRREA did not grant RTC legal rights which FSLIC did not possess to abrogate or repudiate agreements.

Except in rare and exceptional circumstances, inquiry as to the meaning of the language of a statute must not be undertaken when that language is clear and unambiguous. See e.g., Rubin v. United States, 449 U.S. 424, 430 (1981); TVA v. Hill, 437 U.S. 153, 173-74 (1978). Such rare and unusual circumstances may exist when following the letter of the law is absurd or leads to a result so gross as to shock the general moral or common sense. See Crooks v. Harrelson, 282 U.S. 55, 59 (1930). In such a case, there must be something to make plain the intent of Congress that the letter of the statute is not to prevail. See Treat v. White, 181 U.S. 264, 265 (1901). Concluding that FIRREA did not empower RTC to abrogate or repudiate unilaterally resolution agreements to which FSLIC was a party is neither absurd nor shocking. It is reasonable to conclude that Congress intended that RTC honor the terms of contracts which limited FSLIC and taxpayer expenditures and in reliance upon which parties invested large sums of money. Absent a specific statement of Congressional intent to grant RTC new powers to abrogate or repudiate unilaterally such contracts, no such intent can be presumed.

(b) Legislative history.

As noted, the language of Section 21A(b)(11)(B) is clear and unambiguous. We have nevertheless reviewed the legislative history for further evidence of legislative intent. Although sparse, the relevant legislative history supports the conclusion that Congress, in enacting FIRREA, did not intend to grant RTC new powers to abrogate or repudiate unilaterally FSLIC agreements to resolve insolvent institution cases.

Our examination of the legislative history of FIRREA included the following reports of the House of Representatives and Senate: S. Rep. No. 19, 101st Cong., 1st Sess. (Comm. on Banking, Housing and Urban Affairs) (1989), H.R. Conf. Rep. No. 209, 101st Cong., 1st Sess. (Comm. on Conference) (1989), H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess.

(Comm. on Conference) (1989), H.R. Rep. No. 54, 101st Cong., 1st Sess., pt. 1 (Comm. on Banking, Finance and Urban Affairs), pt. 2 (Comm. on Ways and Means), pt. 3 (Comm. on Banking, Finance and Urban Affairs), pt. 4 (Comm. on Rules), pt. 5 (Comm. on the Judiciary), pt. 6 (Comm. on Government Operations), and pt. 7 (Comm. on Banking, Finance and Urban Affairs) (1989). In addition, we reviewed all debates in the Senate and House that were reported in the Congressional Record, Volume 135 for the following dates: April 17-19; June 14-15; June 21-22; and August 3-4, 1989.

In situations unlike this, where statutory language is ambiguous, the authoritative source for ascertaining legislative intent is in committee reports. See Garcia v. United States, 469 U.S. 70, 75-78 (1984). Those reports represent the considered and collective understanding of those Representatives and Senators involved in drafting and studying proposed legislation.

On the subject of repudiating past case resolutions, the only discussions directly on point are contained in the Additional Views section of the House Report. Commenting on an earlier and significantly different version of Section 501, a group of eight Congressmen submitted the following views:

> We further note that Section 501 of H.R. 1278 authorizes the Resolution Trust Corporation to review FSLIC-assisted case resolutions since January 1, 1988, with approval of the RTC oversight board. It is clear by the debate which occurred over this provision at both the Subcommittee and full Committee levels, it is the Committee's intent to suggest that case resolution agreements entered into by the Federal Home Loan Bank Board (FHLBB), including the waivers and forbearance, can be reviewed, but are binding and enforceable. Indeed the Committee believes that the Government has the moral and legal obligation to stand behind every element of these agreements.

H.R. Rep. No. 54, 101st Cong., 1st Sess. 535 (1989).

The legislative history of H.R. 1278 contains no indication that the Committee's intention changed as the language of the Bill evolved into the version ultimately adopted as Section 501 of FIRREA.

Representative Toby Roth also submitted additional comments on the earlier version of H.R. 1278. In those comments, he apparently recognized that the House bill gave RTC no new authority to repudiate prior FSLIC case resolution agreements. With regard to these agreements, he stated: "In this bill I urged that those contracts be reopened, but we only won a halfway measure: a 'review' of their terms and costs." H.R. Rep. No. 54, 101st Cong., 1st Sess. 538 (1989).

While Congressional debates are not an authoritative source from which to discover the meaning of a statute, detailed and explicit debates can provide a reliable extrinsic guide to legislative intention. See Binns v. United States, 194 U.S. 486, 490 (1904); Mitchell v. Kentucky Finance Co., 359 U.S. 290 (1959). The debate on the floor of the Senate does provide such guidance.

The provision directing RTC to review the Resolution Agreements that was finally incorporated in FIRREA was originally proposed in a different form by the Senate Committee on Banking, Housing, and Urban Affairs. The forerunner provision contained an important limitation, stating that RTC "may restructure or exercise legal rights with respect to such agreements where savings would be realized, if restructuring is permitted by the terms of the resolution agreement and is concurred in by the Oversight Board." S. 774, 101st Cong., 1st Sess. 328 (1989) (emphasis added).

The degree to which the Senate Banking Committee Bill authorized RTC to restructure Resolution Agreements was a topic of debate on the floor of the Senate on April 18, 1989. Senator Metzenbaum, a leading critic of the Committee language, objected that the provision did not give RTC "any right whatsoever" to restructure the agreements. He continued, "It says in English that you cannot open them [the Resolution Agreements] unless the agreement says you can open them." Senator Riegle, one of the managers of the bill, believed that a provision allowing FSLIC to repurchase covered assets, which he asserted was common to the agreements, provided leverage that could be used to restructure the agreements. 135 Cong. Rec. S4111-12 (daily ed. Apr. 18, 1989).

As a result of discussions between members of Senator Metzenbaum's staff and Senate Banking Committee staff, an amendment was proposed and included in a comprehensive manager's amendment that was introduced and accepted the following day. The new provision was adopted by the Senate with little debate.

The new provision, among other things, deleted the restriction that Resolution Agreements could be restructured only if permitted by the terms of the agreement, but added new qualifying language stating that in modifying, renegotiating or restructuring Resolution Agreements, RTC may exercise only those legal rights existing before enactment of FIRREA.

Senator Metzenbaum declared himself satisfied with the amendment, stating that the language of the amendment "is far stronger." The Senator continued: "[I]n fact, the language, in my opinion, provides a basis for the reopening or relooking, restructuring, reexamining of the deals that were put to bed in 1988. And within the constraints of the language of the bill, I believe it will give those who continue in control of FSLIC, or its successor organization, the right to go back and say, 'Hey, wait a minute, was that the right

thing to do?'" By his comments Senator Metzenbaum appears to have recognized an important limitation to the powers granted under the amendment. He stated: "The bill does not add any new legal rights, but under the legal rights which are presently in effect, I do not have much doubt that the continuing corporation [RTC] will have a right to reopen or renegotiate some of those deals." 135 Cong. Rec. S4274-75 (daily ed. Apr. 19, 1989).

Nothing in the debate indicates that FIRREA was intended to confer new powers on RTC to repudiate Resolutions Agreements. To the contrary, as finally enacted, Section 21A(b)(11)(B) further reinforced the language ultimately adopted by the Senate, stating that "[n]othing in this paragraph shall be construed as granting the Corporation any legal rights to modify, renegotiate, or restructure agreements between the Federal Savings and Loan Insurance Corporation and any other party, which did not exist prior to the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989." The evolution of Section 21A(b)(11)(B) coupled with the Senate debate support the view that those powers that RTC has to restructure resolution agreements are the same powers that existed before enactment of FIRREA.

Our conclusion that Congress by enacting FIRREA did not intend to grant RTC new powers to repudiate or abrogate unilaterally existing FSLIC resolution agreements is thus supported by the legislative history of the statute.

(c) Judicial decisions.

FIRREA is a new statute and we have found no case law interpreting Section 501. However, a number of recent cases in United States District Courts deal with the authority of the Office of Thrift Supervision ("OTS") to abrogate certain forbearances granted by Federal Home Loan Bank Board ("FHLBB") in connection with resolution agreements. These cases, brought by thrifts, seek to enjoin OTS from abrogating supervisory goodwill and capitalization forbearances granted in pre-FIRREA FSLIC agreements.

A key issue in a number of these cases involves the relationship between FIRREA Sections 401(g) and (h). FIRREA Section 401(h) continues in effect FSLIC and FHLBB orders, resolutions, determinations, and regulations valid on the date that FIRREA became effective "until modified, terminated, set aside, or superseded in accordance with applicable law . . . ." OTS cited this language in support of its position that it was authorized to modify forbearances previously granted by FHLBB. On the other hand, FIRREA Section 401(g) provides that abolition of FSLIC or FHLBB "shall not affect the validity of any right, duty, or obligation of the United States, the [FHLBB], or any other person" which existed on the day before enactment of FIRREA.

In Franklin Federal Savings Bank v. Director, Office of Thrift Supervision, No. CIV-2-90-166 (E.D. Tenn. July 16, 1990), the Court enjoined OTS from abrogating a forbearance agreement that allowed the plaintiff institution to amortize supervisory goodwill. The Court found that the forbearance agreement was binding on successors to FHLBB and FSLIC, i.e. OTS and the Federal Deposit Insurance Corporation ("FDIC"). The Court further held that by issuing a forbearance letter, FHLBB and FSLIC waived their statutory rights and powers with regard to amortization of the supervisory goodwill. Similarly, in Far West Federal Bank v. Director, Office of Thrift Supervision, No. 90-103-PA (D. Ore. May 4, 1990), the Court barred OTS from abrogating a 1987 capitalization agreement between FHLBB and Far West Federal Bank ("Far West"). FHLBB had approved Far West's conversion application and stock purchase agreement. In the agreement FHLBB had granted Far West forbearance from regulatory capital requirements. OTS subsequently claimed that Far West was not in compliance with FIRREA's capital requirements and that FIRREA allowed OTS to abrogate FHLBB's earlier agreement. The Court concluded that the conversion agreement was a contract that did not permit FHLBB to change its position about forbearances. The Court stated: "Congress could not have intended a result so unjust and inequitable as the complete abrogation of a long-term, comprehensive agreement on which private third parties relied to invest large sums of money."

More recently, in Sterling Savings Ass'n v. Ryan, No. CS-90-0175-JLQ (E.D. Wash. Aug. 8, 1990), OTS offered a new justification for repudiating forbearances, arguing that forbearances granted in a series of FSLIC assisted transactions were extinguished by operation of provisions of Section 301 of FIRREA, which amended and restated the Home Owner's Loan Act of 1933 (12 U.S.C. §§ 1461-1468c)(1989). In rejecting the arguments under Section 301, the Sterling court stated: "Without some sort of clear statutory mandate, the court will not lightly infer that Congress has undertaken to abrogate the contractual rights of private citizens." In a footnote, the court peremptorily dismissed OTS's interpretation of Section 401 of FIRREA, citing the Far West decision.[2]

Forbearances were often one element of the assistance which FHLBB granted in connection with agreements resolving insolvent institution cases. Thus, while the above discussed decisions do not address directly the question of whether FIRREA grants RTC new powers to abrogate or repudiate an existing resolution agreement, they do stand for the proposition that after enactment of FIRREA, one component of a contractual arrangement resolving an insolvent institution continues to bind upon successors to FHLBB and FSLIC. It

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[2] The court in Sterling was aware, as are we, that when Congress does enact specific legislation abrogating contracts, issues regarding taking without just compensation can arise under the Fifth Amendment to the Constitution.

would appear to be inconsistent for one component of such an arrangements to be binding upon OTS and FDIC, while RTC is empowered to repudiate the entire agreement.[3]

2. Preexisting Legal Rights

(a) Successor to FSLIC

Having determined that FIRREA does not grant RTC new powers to abrogate or repudiate unilaterally existing FSLIC agreements resolving insolvent institution cases, our next inquiry was to determine whether RTC inherited any authority to restructure the Resolution Agreements from FSLIC. We thus inquired whether RTC is the successor to FSLIC. Although the statute is not explicit, we conclude that if the question were presented to a court, RTC might be declared the successor to FSLIC for the purpose of modifying, renegotiating, or restructuring the Resolution Agreements. To determine the extent of its powers in this regard RTC should thus assume that it succeeds to the same contractual rights FSLIC had with respect to modification of the agreements and has the same, but unenhanced, statutory and common law rights that were available to FSLIC before enactment of FIRREA.

Section 215 of FIRREA amended the Federal Deposit Insurance Act (the "FDIA") by inserting a new Section 11A. Section 11A(a)(1) of the FDIA, as amended by FIRREA, established a separate fund, under the management of FDIC, designated as the FSLIC Resolution Fund. Section 11A(a)(2) authorized the transfer to the FSLIC Resolution Fund of all the assets and liabilities of FSLIC, except as provided in Section 21A of the FHLBA.

As discussed above, Section 21A(b)(11)(B) of the FHLBA requires that "[t]he Corporation shall exercise any and all legal rights to modify, renegotiate, or restructure such agreements where savings would be realized by such actions." Implicit in this language is the assumption that the right to restructure the Resolution Agreements is among the rights excepted from transfer to the FSLIC Resolution Fund by operation of FDIA Section 11A(a)(2). This reading is consistent with the discussion of FIRREA Section 501 contained in the Join Explanatory Statement of the Committee of Conference, which states that "[t]he RTC shall exercise all the rights that FSLIC had to modify, renegotiate, or restructure

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[3] One District Court has permitted OTS to impose new regulatory capital requirements despite the existence of a forbearance letter. The facts of that case appear distinguishable. In Flagship Federal Savings Bank v. Wall, No. 90-00079-GT-(BTM) (S.D. Cal. Feb. 14, 1990), the terms of the forbearance letter itself specifically permitted the FHLBB to rescind all or any portion of the forbearance. See also El Paso Savings Ass'n v. Director, Office of Thrift Supervision, No. EP-89-CA-426-H (W.D. Tex. Jan. 8, 1990).

assistance agreements where savings can be realized." H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 412 (1989).

(b) FSLIC rights.

To determine what rights are available to RTC in connection with modification of the Resolution Agreements, it is thus necessary to determine what rights FSLIC would have had to modify the agreements. The construction of contracts between private parties and the United States government, and the determination of the rights and obligations of the parties under those agreements, are determined by the application of general rules governing construction of contracts between private contracting parties. See, e.g., Priebe & Sons, Inc. v. United States, 332 U.S. 407, 411 (1947); United States v. Standard Rice Co., 323 U.S. 106, 110 (1944). Absent specific statutory or regulatory authority, the government contracts under, and is bound by, the common law. "When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." Lynch v. United States, 292 U.S. 571, 579 (1934).

Notwithstanding that government contracts are controlled by the common law, the government retains the power to abrogate common-law contract doctrines, as well as contracts themselves, by specific legislation. See, e.g., Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 52 (1986); Torncello v. United States, 681 F.2d 756, 763 (1982). Our review of pertinent statutes and judicial decisions did not disclose the grant to FSLIC of any special powers to modify agreements to which it was a party. Absent a grant of specific legislative or regulatory authority, FSLIC's right to modify the Resolution Agreements would have been no greater than the rights possessed by the parties with whom it contracted.

One party to a contract cannot alter the terms of the contract without assent of the other party. Section 21A(b)(11)(B) of the FHLBA explicitly directs the RTC to review all Resolution Agreements to determine where rights of modification exist and instructs RTC to exercise such rights. Where FSLIC had by agreement reserved the right to modify the Resolution Agreements, such rights thus could be exercised by RTC. Absent such a reservation of rights, an enforceable contract may only be modified if the modifications have all the requisites of a valid and enforceable agreement (i.e. offer, acceptance and consideration). In effect, a new bargain must be struck.

The law recognizes a limited number of situations that may give one party to a contract the unilateral right to avoid or disaffirm the legal relations created by the contract.

Where one or more parties to a contract have such a power, the contract is typically referred to as "voidable." 1 S. Williston, A Treatise on the Law of Contracts § 15 (3d ed. 1957).[4]

Generally, the circumstances under which such a right may arise are: (i) fraud/ misrepresentation (i.e. where a party's agreement to a contract is induced by a fraudulent or material misrepresentation by the other party upon which the recipient is justified in relying); (ii) mistake (i.e. where a mutual mistake is made as to an existing or past fact which forms the basis of the contract and, under more limited circumstances, where a unilateral mistake of fact is made about the underlying assumption of the contract); (iii) duress, coercion or undue influence (i.e. where a party is induced by compulsion or unfair persuasion to assent to a contract, contrary to his will and inclination). 1 S. Williston, A Treatise on the Law of Contracts § 15 (3d ed. 1957) §§ 1456-1627; Restatement (Second) of Contracts §§ 151-177.[5]

Unless a transaction can be brought within the scope of one of these categories, the fact that one party to a transaction is dissatisfied with the transaction or feels that it could have gotten a better deal is insufficient to make the transaction voidable. We have not reviewed the terms of the Resolution Agreements and offer no opinion as to whether any of the preceding remedies would be available in a specific case.

OPINION

Based upon: (i) the clear and unambiguous language employed by Congress in Section 21A(b)(11)(B) of FHLBA, as amended by Section 501 of FIRREA, (ii) the legislative history of the section, discussed above and (iii) the judicial decisions discussed above, we are of the

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[4] This discussion assumes that the essential elements to a valid, binding contract (offer, acceptance and consideration) have been satisfied and does not address the consequences of a material breach of a contract by one party, which may give rise to a right of rescission in addition to other contractual remedies. The law also recognizes situations under which a contract is deemed "void," that is, where no legal obligation arises (e.g., illegal agreements, contracts against public policy, unconscionable agreements, contracts in violation of an ordinance, statute or constitution) and other situations where an otherwise binding contract is simply unenforceable (e.g., contracts barred by a statute of limitations or statute of frauds, or where the remedy for a breach has been lost). 1 S. Williston, A Treatise on the Law of Contracts §§ 15-16 (3d ed. 1957); Restatement (Second) of Contracts §§ 178-185 (1981).

[5] This summary reflects general common law principles of contract law only and is not intended as a statement of the law of any particular jurisdiction. The legal principles above and the governing standards may vary from state to state.

opinion that FIRREA does not grant RTC new legal rights to abrogate or repudiate unilaterally the agreements entered into by FSLIC and referred to in Section 21A(b)(11)(B) of FHLBA as amended by FIRREA. To the extent that RTC succeeds to the contractual rights of FSLIC for the purpose of modifying, renegotiating, or restructuring the Resolution Agreements it has the same, but unenhanced, statutory and common law rights that were available to FSLIC before enactment of FIRREA.

APPENDIX V

THACHER PROFFITT & WOOD

1500 K STREET, N.W.
WASHINGTON, D.C. 20005
202-347-8400
800-638-6409
FACSIMILE 202-347-6238

TRICIA K. BONNER
W. EDWARD BRIGHT
ROBERT F. BRODEGAARD
PHILLIP C. BROUGHTON
CHARLES D. BROWN
DIANA G. BROWNE
JEREMIAH S. BUCKLEY*
ALBERT J. CARDINALI
CHARLES A. DIETZGEN
KATHRYN DIETZGEN
DANIEL J. DRISCOLL, III
JOSEPH PHILIP FORTE
O. GERARD GUERTSEN
JOEL B. HARRIS
RICHARD A. KILÉ
RAYMOND S. JACKSON, JR.
STEPHEN S. LUDEMANN

EDWARD R. LEAHY*
DOUGLAS J. McCLINTOCK
DAVID C. MILLER
RANDAL A. NARDONE
LOUIS H. NEVINS*
LAURIS G. L. RALL
JAMES E. SHORTER, JR.
DONALD F. SIMONE
FRANCIS X. SULGER
DONALD B. SUSSWEIN
LAWRENCE A. SWENSON
THOMAS N. TALLEY
CORNELIUS S. VAN REES
STEPHEN T. WHELAN
OMER S. J. WILLIAMS
STEPHEN B. WILSON
JOHN M. WOODS

*Not admitted in New York

TWO WORLD TRADE CENTER
NEW YORK, NEW YORK 10048
212-912-7400

11 MARTINE AVENUE
WHITE PLAINS, NEW YORK 10606
914-422-8200

AFFILIATED WITH
WHITTENBURG WHITTENBURG & SCHACHTER

1960 LINCOLN PLAZA
DALLAS, TEXAS 75201
214-740-3700

1200 AMARILLO NATIONAL PLAZA TWO
AMARILLO, TEXAS 79101
806-372-5671

MEMORANDUM

To: Resolution Trust Corporation

From: Donald B. Susswein DBS
Jeremiah S. Buckley JSB

Date: September 12, 1990

Re: Clarifying The Tax Treatment Of "Losses" On Covered Assets

I. Introduction And Summary

This memorandum contains a more detailed legal analysis of the recommendations on the above-captioned subject in the McGladrey & Pullen/Thacher Proffitt and Wood report.

Our analysis of the tax treatment of covered assets was prompted by unresolved questions relating to the tax consequences of the FDIC's repurchase of covered assets. To help answer these question we reviewed the legal precedents, theories and rationales supporting the more general notion that tax losses are allowed upon the sale of a covered asset to a third party (or

upon the write-down of the asset) without regard to the receipt of full compensation from FSLIC/FDIC for any economic loss.

As a result of this analysis we reached the legal conclusion that a tax loss does not appear to be allowable either (1) when a covered asset is repurchased by the FSLIC/FDIC for an amount equal to the taxpayer's basis, or (2) when the asset is sold to a third party or written down, and the holder is fully and directly compensated with FSLIC/FDIC capital loss coverage for any economic loss. As described more fully below, neither the literal language of the applicable statutory provisions, their legislative history, nor longstanding published IRS rulings dealing with similar issues support the allowance of a loss. Although one unpublished IRS Technical Advice Memorandum (TAM) issued in 1986 indicates that a loss is allowable, such a TAM is not generally considered binding precedent -- except for the taxpayer for which it was issued. Later IRS rulings unofficially published in LEXIS appear not to rule on the loss issue, and contain rulings on related points that seem inconsistent with the allowance of a loss.

If our legal conclusion is accepted as correct, then significant cost savings are likely to result if the IRS or Congress clarifies the law accordingly. We assumed that Congress and the RTC were not seeking recommendations in the tax area that would be tantamount to retroactively revoking or modifying the clear holdings of IRS private letter rulings or closing agreements in the hands of the taxpayers to whom they had been issued. We assumed that Congress would not wish to interfere with the normal, well-established procedures under which the IRS administers the tax law, and the legitimate expectations of taxpayers regarding those procedures. To our understanding, however, the private rulings issued in connection with the reviewed transactions generally did not rule on this issue. In addition, some of the rulings contain holdings on other issues which seem inconsistent with the allowance of a loss.

At the same time, the parties negotiating the transactions on both sides may well have assumed the allowance of these tax losses. It is also possible that IRS officials -- in discussions with FSLIC personnel, acquirers and potential acquirers -- may have orally indicated some level of acquiescence or agreement with the notion that such losses were allowable. Thus, even if the IRS and the Congress accept our legal conclusion, they must still decide to what extent they feel that they should not disturb the expectations of acquirers, even if those expectations were premised on a view of the law that now appears to be incorrect and on which no closing agreement or private letter ruling was issued.

The appropriate weight, if any, to be accorded to such equitable considerations may vary depending on the facts of the

case. If the Congress decides to take such equitable considerations into account, it could attempt to craft a rule that falls somewhat short of disallowing all losses. In particular, Congress might wish to focus on disallowing losses in the case of asset repurchases -- although it is our view that the legal argument for disallowing losses in all cases is just as compelling. Alternatively, the Congress or the IRS may wish to consider clarifying the non-allowability of covered asset losses in all cases addressed by this memorandum, while allowing any equitable concerns based upon the expectations of the parties to be resolved as a matter of contract law or other law applicable to the negotiated agreements.

II. Description Of Legal Issue And Related Problems

When an institution disposes of a "covered asset" (or writes down its value) many have assumed that the institution will be entitled to claim a tax loss, even when the shortfall between the asset's market value and the taxpayer's basis is fully made up by FSLIC or FDIC assistance payments (hereinafter "Assistance"). For example, if an asset with a tax basis of $100 is disposed of for $70, and the holder receives Assistance of $30, some have assumed that the holder would be entitled to claim a tax loss of $30. Similarly, if the same covered asset were repurchased from the holder by the FDIC for $100, some have assumed that a tax loss would be allowable, because all or a portion of the amount received from the FDIC would be treated as Assistance. Such a tax loss would not correspond to any economic loss suffered by the institution, but would arise only because of the taxpayer's arguable ability to disregard assistance payments in determining the existence of a loss.

The potential tax benefits associated with such a loss depend on the nature of the covered asset and the taxpayer's accounting method. In the case of a loan or other property treated as a "debt", a bad debt loss would generally be subtracted from the institution's bad debt reserve (often generating the immediate right to a corresponding tax deduction to restore the reserve balance to its previous level). In the case of any taxpayer not on the reserve method, a bad debt loss would be deductible from gross income. In the case of an asset not treated as a "debt" a deductible loss would arise under Section 165, regardless of the taxpayer's method of accounting for bad debts.

To the extent the tax benefits of such losses are not returned to the Government under the terms of an assistance agreement, the Government's overall cost for the transaction will be increased if the loss is allowed. The possible allowance of such a loss may also create perverse incentives and rewards for asset managers that are not consistent with the purposes of the assistance agreements. For example, where the FDIC exercises its

contractual right to repurchase an asset at its face amount, possibly because of concern with the holder's performance as an asset manager, the holder may realize a valuable tax loss if all or a portion of the purchase price is treated as Assistance and disregarded for tax purposes. It is even possible -- taking to their logical conclusion what we believe to be the relevant legal theories -- that the loss would equal the entire book value or basis of the asset, under the theory that 100% of the purchase price constitutes assistance that should be disregarded in the computation of income or loss.[1] Even if the loss were limited to

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[1]The treatment of asset repurchases is not entirely clear, even if one assumes that Assistance is to be disregarded in computing losses. It has been suggested that only the portion of the asset's purchase price in excess of its market value should be treated as Assistance. However, to the extent the repurchase price is paid or treated as being paid under the authority of Section 406(f) of the National Housing Act, or a successor provision, the entire repurchase price could be treated as tax-exempt Assistance. This is because Section 597 of the Internal Revenue Code of 1986 ("Code") does not appear to distinguish between the portion of assistance payments that are economically reasonable and those that have a subsidy element or serve a uniquely Governmental purpose. If such a distinction existed, for example, interest on FSLIC and FDIC notes might be includible in gross income, under the theory that such payments represent economically reasonable compensation for the use of money. Indeed, negative net worth assistance, covered asset payments, and yield maintenance all appear to be economically reasonable payments for an acquirer's assumption of insured deposit liabilities which the Government would otherwise be required to satisfy.

Assuming that Code Section 597 required the entire purchase price to be disregarded for loss purposes, it would seem that a loss equal to 100% of the asset's basis would arise under Code Section 165 in any case where a covered asset other than a bad debt is repurchased (such as stock in a subsidiary).

In the case of a covered asset treated as a "debt" under Code Section 166, the issues are more complicated. Any bad debt loss should be limited to the excess of basis over the asset's fair market value (excluding any right to receive Assistance). This is because (1) a bad debt loss can only be taken on the basis of an asset's worthlessness or partial worthlessness, and (2) even if FSLIC or FDIC payments are excluded in this determination the asset still has a value at least equal to its market value determined without regard to any right to receive Assistance. However, where such an asset is then sold to the Government it is arguable that a disposition loss would arise under Code Sections 165 and 1001 on account of the taxpayer

the excess of tax basis over value (determined without regard to the covered asset agreement) such a determination of value may be inherently difficult where the asset is repurchased by the Government at its face value. Moreover, it is questionable whether the holder should be rewarded with any tax loss in this circumstance.

III. Discussion of Legal Authorities

A. Principal Statutory Provisions

For the cases at issue Section 597(a) of the Internal Revenue Code of 1986 ("Code")[2] provides that payments of FSLIC assistance ("Assistance") are to be excluded from gross income. Section 597(b) further provides that no adjustment to the basis of the recipient's assets is to be required on account of this exclusion. The statutory rule against basis adjustments ensures that the exclusion from gross income granted by Section 597(a) is permanent, and not merely a temporary exclusion or deferral of the type that would be afforded if Assistance were treated as a non-shareholder capital contribution. See, General Explanation of the Economic Recovery Tax Act of 1981, Staff of the Joint Committee on Taxation, December 31, 1981, at page 151.[3] Under these rules, if a taxpayer holding a covered asset with a basis

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having sold a valuable asset for a purchase price that is treated as zero under Code Section 597. This second loss would arguably be equal to the asset's remaining basis (after reducing basis by the amount of the bad debt loss realized as described above). In this fashion two losses totalling 100% of the asset's basis could arise upon the repurchase of the asset.

[2]All references to "Section" numbers refer to provisions of the Code, unless otherwise stated.

[3] For example, if cash assistance were characterized as a non-shareholder capital contribution under Section 118 and Section 362, it would be excluded from gross income at the time it was received, but the basis of the taxpayer's other assets would be reduced by the amount of the Assistance. As a result, the amount of the FSLIC payment would indirectly be included in gross income upon any sale or disposition of the taxpayer's other assets, or through the reduction of their depreciable basis. In the case of a financial institution whose assets consist predominantly of loans with a weighted average life of, say, 7 to 10 years, treatment of FSLIC assistance as a non-shareholder capital contribution would be tantamount to a seven to ten year deferral of the income, rather than a permanent exclusion.

of $100 disposes of the asset for $70 and receives $30 of Assistance, it is clear that the $30 of Assistance will not be included in gross income and will not give rise to any reduction in the basis of the taxpayer's assets.

While Section 597 clearly provides that Assistance is to be excluded from gross income, this does not necessarily mean that a deductible loss should be realized -- by ignoring the Assistance in applying the Code provisions applicable to the determination of losses. In the case of a thrift institution holding covered assets treated as "debts" (i.e., loans, and in most cases property taken by foreclosure or deed in lieu of foreclosure) a loss is allowable under Section 166 and the related reserve method provisions only to the extent the asset becomes worthless or partially worthless. Accordingly, in order to sustain a bad debt loss on a covered asset one must ignore the covered asset agreement in determining the asset's value for this purpose. In the case of other assets, a loss upon sale or disposition can arise under Sections 1001 and 165 only if the "amount realized" on the disposition is less than the property's basis. Accordingly, to claim a loss on the disposition of a covered asset the taxpayer must exclude Assistance from the "amount realized" as well as excluding it from gross income.

Section 597 does not by its terms provide that Assistance is to be excluded, ignored or disregarded in determining the amount of the taxpayer's loss upon disposition of an asset, or in determining whether an asset is worthless or partially worthless. Section 597 also does not provide that Assistance is to be excluded from the "amount realized" upon the sale or disposition of an asset under Section 1001.[4] Finally, Section 165 expressly provides that losses are allowable only to the extent they are "not compensated for by insurance or otherwise." (Emphasis supplied.) Where Assistance expressly serves the function of indemnifying against losses on specified

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[4] The distinction between an exclusion from "gross income" and an exclusion from "amount realized" is important. As long as the total amount realized on an asset does not exceed its basis, the taxpayer has no "gain" and no inclusion in gross income even without Section 597. This is because taxable gains from the sale or disposition of property are defined under Section 1001 as the amount by which the "amount realized" upon a sale or disposition exceeds the taxpayer's adjusted basis. Thus, if the Assistance received in the previous example were $40, the total amount realized would be $110 and the taxable gain included in gross income would be $10, unless Section 597 applied. In such a case Section 597 ensures that the $10 of gain will be permanently excluded from gross income.

assets and provides compensation equal to the full amount of such losses, Section 165 would appear to bar any loss deduction.

As far as Section 165 is concerned, it may be argued that the exclusion of an item from gross income implies that the item should also be excluded from the definition of "compensation" for losses under Section 165. Under this view a loss would not be disallowed if it were compensated for solely with Assistance that is tax-exempt under Section 597, or compensated for with other amounts excludible from gross income. However the IRS has consistently ruled that the exclusion from gross income of a Governmental or charitable payment in compensation for a loss does not require that the payment be disregarded in determining the amount of any deductible loss. In several cases these rulings have involved Federal payments and programs closely analogous to Assistance. See, e.g., Rev. Rul. 76-131, 1976-1 C.B. 16 (holding that compensatory payments under the Disaster Relief Act Amendments of 1974 are in the interest of the general welfare and not includible in the gross income of the recipients, but that no deduction is permitted under section 165(a) with respect to amounts specifically reimbursed by such payments). Also see, Rev. Rul. 131, 1953-2, 112 (holding that an employer's payments to compensate employees for injuries and losses from a tornado are excludible from gross income as gifts, but that the recipients should nevertheless take the payments into consideration in computing casualty losses to the extent the payments are used as reimbursement for or replacement of property damaged or destroyed, and that reimbursements in excess of basis will not increase such property's basis); Rev. Rul. 64-329, 1964-2, C.B. 58 (reaffirming prior ruling, but distinguishing case where payments were made by relatives and neighbors and there was no limitation or directive relating to the manner in which the money was to be used by the recipient, holding that such gifts by neighbors and relatives did not reduce amount of casualty losses). Cf. Shanahan v. Commissioner, 63 T.C. 21, (1974) (holding that cancellation of disaster loan indebtedness under a Federal relief program will reduce the amount of deductible loss under Section 165(a), but suggesting in dicta that the issue turns on whether the cancellation "was more in the nature of a gift or insurance.")

The idea that a "loss" compensated for by insurance is not a deductible loss, even if the compensation payment would not be includible in gross income, would seem to be equally applicable to bad debt losses under Section 166. The strictly technical question appears to be whether Assistance, which is clearly excluded from gross income, is also to be disregarded in determining whether a covered asset is worthless or partially worthless under Section 166 and the related reserve method provisions. As mentioned above, Section 597 does not so provide by its terms. Moreover, as a matter of statutory interpretation it should be noted that the Code is replete with situations where

items are statutorily excluded or disregarded for purposes of computing gain (but not loss), loss (but not gain), income (but not value), or value (but not income), and so forth. Because these terms are used with great precision in the Code there is no basis for concluding that a statutory exclusion from gross income requires that the excluded item should be ignored for all other Federal tax purposes.[5] To the contrary, exclusions and exemptions are generally construed strictly, rather than liberally.

In this regard it is particularly noteworthy that several acquirers appear to have obtained IRS private letter rulings holding that the right to receive FSLIC assistance will not be disregarded in valuing a covered asset for purposes of determining whether such an asset has a "built-in deduction" or built-in loss to which certain limitations would apply under the consolidated return rules. See, e.g., PLR 8914021, December 29, 1988; PLR 8912043, December 27, 1988; PLR 8914020, December 29, 1988. The IRS apparently ruled in these cases that a covered asset will be considered to have a value equal to its fully guaranteed amount, and therefore considered not to have any built-in losses at the time of the acquisition. The effect of this holding is to make it easier for the acquirer to avoid a limitation on the use of built-in losses contained in the consolidated return regulations. If the aggregate amount of built-in losses associated with an acquisition are less than a specified de minimis amount, all of the acquired built-in losses will be exempt from the so-called "SRLY" limitations, and therefore usable against taxable income of other group members.

These rulings clearly indicate that Section 597 is not to be applied simply by disregarding Assistance for all Federal income tax purposes. If that were the case the covered assets' value for purposes of the consolidated return regulations would be determined without regard to the asset coverage. That would have made it more difficult to satisfy the de minimis rule, and more likely that any built-in losses on covered assets or other acquired assets would be subject to the SRLY rules. These rulings apparently did not address the question of whether Assistance should be taken into account or disregarded under

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[5]For example, interest on state and local bonds is exempt from income taxation under Section 103. However the value of such bonds is not disregarded in computing the value of a decedent's gross estate. Interest on FSLIC notes is exempt from taxation, yet the IRS has ruled that the face amount of FSLIC notes are considered to be qualified assets of a thrift for purposes of satisfying the 60% asset test of Section 7701(a)(19)(C). Section 1091 disallows losses on "wash sales" of securities, but does not prevent the recognition of gains on such transactions.

Sections 165, 166, and the related reserve method provisions. However, if Assistance is to be taken into account in determining whether an unrecognized loss exists, logic would suggest that it also be taken into account when the taxpayer purports to recognize that same loss. If that is the case, then no bad debt loss would arise under Section 166 unless the value -- taking into account the asset coverage -- was less than the taxpayer's basis.[6]

Acquirers may argue that the allowance of a loss in these circumstances is indicated by statutory language enacted in 1986 providing that Section 265(1) (now Section 265(a)(1)) will not apply to disallow an otherwise allowable deduction solely because it is allocable to income that is exempt under Section 597. That provision (and a similar provision enacted in 1988 applicable to Section 265 in its entirety) appear to be directed at the deductibility of expenses that might otherwise have been disallowed to the extent they were attributable to the receipt of FSLIC assistance. This ensures, for example, that otherwise tax-exempt interest on FSLIC notes, otherwise tax-exempt yield maintenance payments, and similar tax-exempt payments will not be effectively included in gross income through the disallowance of an allocable portion of the taxpayer's otherwise allowable deductions for salaries and other expenses.

Any reliance on the inapplicability of Section 265 in this context appears to be misplaced. A statute overriding Section 265 cannot create a deduction or loss where none exists under otherwise applicable law.[7] Whereas interest and other deductible expenses give rise to a deduction which Section 265 might disallow if it were applicable, a loss under Section 165, Section 166 or the relevant bad debt reserve provisions must first arise before Section 265 even becomes relevant. As described above, such a loss does not appear to arise in the first instance.

It may also be suggested somehow that Section 597(b), which provides that no basis adjustment to the acquirer's assets

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[6] Any private letter ruling issued to a taxpayer expressly providing for a bad debt loss or disposition loss -- by disregarding the receipt of Assistance for that purpose -- would of course present a different issue of law and equity. As described above, we have assumed that the Congress and the RTC were not seeking recommendations that would be tantamount to retroactively changing the tax laws, or revoking a private letter ruling from the taxpayer to whom it was issued.

[7] Section 265 provides that no deduction shall be allowed for any amount "otherwise allowable as a deduction" which is allocable to one of more classes of exempt income.

is to be made on account of the exclusion of FSLIC assistance, warrants the allowance of a loss. This suggestion is lacking in merit. We have concluded that a loss would be allowable only if the tax law (1) disregarded the acquirer's right to Assistance in the determination of the asset's value, or (2) excluded Assistance from "amount realized" and from the concept of loss "compensation" in Section 165. None of these issues are addressed by Section 597(b).

As described above, Section 597(b) was originally enacted to ensure that the exclusion of assistance from gross income is a permanent exclusion, rather than a temporary exclusion of the type accorded under Section 118 for non-shareholder capital contributions. It does this by ensuring that the basis of the taxpayer's assets is not reduced by the amount of excluded assistance -- as would be the case for non-shareholder capital contributions.

Our analysis of the loss issue does not anywhere suggest that any basis adjustment occurs -- in contravention of Section 597(b)) -- and does not rely on any basis adjustment to conclude that a loss is disallowed. To the contrary, under our analysis the taxpayer's basis remains his carryover basis, with no adjustment. Nevertheless, we conclude that a loss is not allowed because (1) the fair market value of the asset, taking into account the asset coverage, is not less than the taxpayer's carryover basis, and (2) the amount realized, taking into account the capital loss payment, is not less than the taxpayer's carryover basis.

B. Significant Contrary Arguments

The strongest argument in favor of allowing a loss would be based on an IRS' Technical Advice Memorandum issued in 1986. PLR 8637005, May 30, 1986. This unpublished Memorandum indicates that a loss, of an unspecified amount, is allowable despite the presence of a similarly unspecified amount of FSLIC assistance intended to compensate for the loss. Acquirers may argue that they are entitled to rely on this Memorandum, whether it is correct or not, for the proposition that Assistance is to be ignored in determining the allowance of a loss. The principal response to this argument is that, unlike a Revenue Ruling or a Regulation, an unpublished Technical Advice Memorandum may not be cited as precedent, and generally can be relied upon only by the taxpayer with respect to which it was issued.[8]

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[8] The IRS' private ruling positions were described by the Joint Committee on Taxation Staff in a 1989 pamphlet as giving rise to a loss on the disposition of a covered asset, despite the receipt of a compensatory assistance payment. Joint Committee on Taxation, Current Tax Rules Relation To Financially Troubled

In practice, many taxpayers and tax advisors do rely on such materials as an indication of the way in which the IRS is likely to analyze a particular case, even if the material may not be cited as binding authority. In such cases it is important for taxpayers and their tax advisors to consider the extent to which such unofficial material indicates that the IRS has carefully considered all of the relevant authorities, and was considering such authorities in the context of a truly comparable factual situation. In this regard it should be noted that both the legal analysis and the factual description in this Memorandum appear to be extremely weak reeds to support a generally applicable conclusion that fully reimbursed losses on covered assets are fully deductible.

The Memorandum describes a situation where covered asset losses and other expenses are reimbursed by the FSLIC, and tax losses are also claimed by the recipient. The precise amount of the tax losses and the precise amount of the compensation are not indicated in the text of the Memorandum as released to the public. The Memorandum's legal discussion assumes that losses and expenses arise and that compensation for the losses and expenses is excluded from gross income. The discussion then cites Section 265(1) (disallowing expenses allocable to tax-exempt income) and concludes that Congress did not intend for that provision to apply to payments subject to Section 597. The Memorandum concludes that the taxpayer "may deduct expenses and losses, reimbursed with contributions from FSLIC that are tax exempt under section 597(a) of the Code."

As described above, where Section 265 applies it may disallow an otherwise allowable deduction, but the inapplicability of Section 265 cannot create a deduction or loss where none exists. Accordingly, if the Memorandum was intended to address the allowance of a loss the legal analysis seems to skip over the most important legal issues. There is no discussion of how any loss on covered assets arises in the first

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Savings and Loan Associations (JCS-3-89), February 16, 1989, at 39. The Joint Committee Staff was careful to point out in this pamphlet that "some of the more technical tax consequences associated with the receipt of [Assistance] are still uncertain" and that their discussion reflected, "the apparent administrative practice of the IRS on some of these issues, as that practice is revealed in recently issued private letter rulings." The Staff also pointed out that private letter rulings "are binding on the IRS only with respect to the taxpayer who requested the ruling. . . may not be used or cited as precedent, and may not in all cases accurately reflect the current IRS position on a particular issue."

instance (although there is a description of how a bad debt loss is treated for a thrift institution on the reserve method) and there is no discussion of how the provisions of Section 165 -- disallowing losses that are fully compensated for by insurance -- are avoided. There is no discussion of how the holdings and explanations in Rev. Rul. 76-131, 1976-1 C.B. 16, Rev. Rul. 131, 1953-2, 112, and Rev. Rul. 64-329, 1964-2, C.B. 58 are to be distinguished or overruled.

Moreover, the facts underlying the Memorandum are not entirely clear. In particular, that case may well have involved an agreement to share 100% of the tax benefits with the FSLIC.[9] If that is the case, the Memorandum may well have stood only for the proposition that Sections 597, 165, 166 and the related reserve method provisions will be interpreted to allow a loss where the tax benefits enjoyed from the loss, together with the Assistance, result in the taxpayer receiving no more than full compensation for the loss. For example, the Memorandum may have been intended to provide that a pre-Assistance loss of $30 for a taxpayer in the 50% tax bracket will be allowed only where the Assistance is limited to $15 under a tax benefit sharing agreement. It may have been argued at the time that such a result -- which would reduce the FSLIC's cost of resolving insolvent institutions but would not have provided any net benefit to the acquirer -- was intended by Congress when it enacted Section 597. Such a ruling certainly would not have created the anomalous situation of an acquirer receiving a tax benefit when the FSLIC or FDIC seeks to repurchase covered assets at their full face value.

Acquirers may also argue that Congress itself may have known or assumed that fully compensated "losses" on covered assets were deductible when it enacted Code Section 597(c) in October of 1988, which purported to reduce the tax benefits of FSLIC and FDIC assistance by reducing various tax attributes -- including built-in losses -- by 50% of the amount of excluded Assistance. Section 597(c) generally applies to acquisitions after December 31, 1988, and thus is legally inapposite to most of the cases at issue here. Even if the provision were applicable, however, it can be shown that Section 597(c) is not premised on an assumption that all covered asset "losses" are deductible without limitation, and does not pre-empt or override

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[9]The Memorandum describes one of the covered assets, stock of a subsidiary, as generating a reimbursement claim against the FSLIC for "p" dollars. The text of the Memorandum explains that, "the loss on the sale of Corp. C resulted in a capital loss or [sic] r dollars, of which p dollars was reimbursed by FSLIC." (Emphasis supplied.) This suggests that the reimbursement by FSLIC may have been on an after-tax basis.

other limitations on the allowance of such losses, or any of the other tax attributes subject to reduction.

Section 597(c) was a somewhat hastily conceived provision intended to reduce the revenue costs of a twelve month extension of the FSLIC provisions, then scheduled to expire on December 31, 1988. The expiring provisions included Section 597 as well as provisions of Sections 368 and 382 effectively providing more liberal rules for the preservation, carryover and utilization of net operating losses and built-in losses. The 1988 statute provided that for every dollar of tax-free FSLIC or FDIC assistance that was received, there would be a 50 cent reduction in the taxpayer's (1) net operating loss carryovers, (2) interest deductions and (3) recognized built-in losses, in that order.

Section 597(c) was not a pre-emptive provision, but one that added a new limitation. The fact that Congress required a 50% cut-back in net operating losses, for example, did not mean that Congress was assuming that all other statutory or regulatory limitations on the use of such losses were pre-empted. It did not mean, for example, that the statutory limitations of Section 172 on the number of years to which net operating losses could be carried were pre-empted or overruled and replaced with the simple 50% cut-back of Section 597(c). Similarly, Section 597(c) cannot be read as overruling statutory and other limitations that may apply to the allowance of recognized built-in losses -- before the 50% cut-back provision even applies.

In addition, there is nothing in the text or operation of Section 597(c) to indicate that Congress was focusing on the issue of whether "losses" that were directly compensated for with Assistance were deductible losses in the first instance. The 50% cut-back did not assume any direct relationship between any particular assistance payment and any particular attribute subject to reduction, and did not depend on the existence of such a direct relationship in order for it to apply. The attribute reduction was performed in the mechanical order described above, without regard to the nature of any specific assistance payment. As a result, recognized built-in losses might be reduced by the 50% cut-back rule even if they were not directly compensated for with Assistance.[10] And -- if one assumes, arguendo, that

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[10]For example, assume an institution whose net operating loss carryovers had all expired under Section 172 before the acquisition. If the acquirer received $100 of negative net worth assistance on the day of the acquisition, and had $40 of interest expense and $10 of recognized built-in losses in its first year following the acquisition, the institution would be prevented by Section 597(c) from deducting these built-in losses or interest expenses. This example is noteworthy for several reasons.

directly compensated losses are otherwise allowable -- there might be cases in which the 50% cut-back would not apply to limit those losses, because it had been applied instead against the other attributes subject to earlier reduction under the mechanical rules described above.

In sum, there is nothing in the language or operation of Section 597(c) to indicate that it was intended to override the provisions of Sections 166 or 165 -- which appear to prevent a loss in this context -- any more than it was intended to override Section 172 -- which provides in some cases that net operating losses will be disallowed even in the absence of the 50% cut-back provision. And there is nothing to indicate that any particular operation of Section 166 or Section 165 in this context was necessarily understood, assumed, or endorsed when Section 597(c) was enacted.

IV. Clarifying The Law

A. Possible Approaches

Congress or the IRS might wish to review this area and consider clarifying the law. There are a number of possible approaches that could be considered.

The narrowest form in which such a clarification might be drafted would provide that the repurchase of a covered asset by the Government for an amount equalling 100% of its adjusted basis will not result in the recognition of any loss for purposes of Section 166 or Section 165. This would ensure the ability of the FDIC to repurchase assets that the FDIC concludes are not

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First, it illustrates that the 50% cut-back of net operating losses and built-in losses does not override or pre-empt other statutory limitations on such losses (such as the rules of Section 172 limiting the years to which net operating losses may be carried). Secondly, it illustrates a case where a recognized built-in loss apparently would have been fully deductible in the absence of Section 597(c) because there was no direct relationship between the assistance payment and the realization of the loss. See, Rev. Rul. 64-329, 1964-2, C.B. 58. Indeed, such a loss would arguably have been deductible, and the $100 of assistance arguably excluded from gross income, even in the absence of Section 597. This and other cases illustrate the way in which Section 597(c) can produce harsher results in some cases than if the transaction were done without any benefits from the special tax provisions. An analysis of the "rough justice" approach of Section 597(c) thus reveals very little, if any, of what Congress expected or assumed was the otherwise applicable law under Section 597.

being appropriately managed without awarding an inappropriate tax benefit to the acquirer.

Congress could also consider the appropriateness of a more general clarification that FSLIC or FDIC assistance should not be disregarded in the determination of whether an asset is worthless (for purposes of deducting bad debt losses under Section 166), and should not be excluded from the "amount realized" upon a disposition of an asset to which Section 165 applies, or from the definition of "compensation" in Section 165, where such exclusion is not necessary in order to exclude the assistance from gross income under Section 597. We have assumed that Congress would not want to apply such a clarification where a taxpayer had been issued an IRS private ruling or closing agreement specifically holding to the contrary.

The effects of the broader clarification on Government costs would vary with the terms of the assistance agreements.

(a) In cases where the tax benefits from such losses are not shared with the FSLIC or its successor in any fashion, such a clarification or modification should reduce the overall cost of the transaction to the Government. This would occur because of increased tax liability for acquirers, without any offsetting increase in assistance.

(b) In cases where the FSLIC or its successor is obligated to reimburse losses on covered assets only on an after-tax basis under a "with and without" analysis, this clarification of the tax law should automatically adjust the amount of assistance payable under the contract, with the result that no net costs or savings to the Government will result.

B. Arguments For And Against Clarifying The Law

Where the tax benefits from purported losses on covered assets are not expressly shared, acquirers may argue that the anticipated enjoyment of this tax benefit was part of their overall bargain, and that clarifying or modifying the law in this regard is unfair. In some cases acquirers may argue that some form of implicit sharing of tax benefits is reflected elsewhere in the overall transaction, such as with the issuance of warrants, profit sharing rights, or agreements to accept reduced amounts of other types of assistance.

On the other hand, it can be argued that the right to enjoy tax losses of this nature may be too speculative to have been effectively bargained over -- since the value of the covered assets upon their ultimate disposition is entirely uncertain. For example, if the acquirer were fortunate enough to see a substantial appreciation in the value of its assets -- due to favorable economic conditions or good management -- the anticipated loss and resulting tax benefit would be reduced. It is difficult to see why the receipt of 100% of the face amount of a covered asset from a third party (which would generate no tax benefits) should be treated differently from the receipt of 70% of the face amount of a covered asset from a third party and 30% from the FSLIC or its successors.

It can also be pointed out that acquirers apparently had the opportunity to avoid the risks of any uncertainty regarding applicable tax law -- but in some cases decided to bear those risks. Any acquirer that agreed to provide 100% of the tax benefits to the Government -- as many did -- effectively passed all of the risk associated with the tax treatment of these complex transactions to the Government. Such an acquirer would not have needed to obtain any comfort or guidance on the finer points of applicable tax law under Section 597, since the economic risk associated with the loss of a tax benefit would be borne by the Government.

In cases where an express private letter ruling or closing agreement was obtained from the IRS, we have suggested that the holding should not be disturbed by Congress or the IRS. If no ruling directly on point was obtained by the taxpayer, however, a different case is presented. By negotiating for the retention of substantial tax benefits the acquirer was effectively assuming the risk associated with any aspects of the tax law that were uncertain or foreseeably subject to change. To the extent the law on this point was uncertain -- or should reasonably have been viewed as uncertain in light of all the relevant authorities and precedents -- it may be appropriate for acquirers to bear the burden of a reasonably drawn clarification of the law in this area.

Where IRS personnel may have orally or informally indicated their agreement with or acquiescence in the view that losses were allowable, Congress and the IRS would presumably evaluate what its normal policies are with respect to taxpayer reliance on such informal statements or assurances that may have been given, taking into account all of the facts and circumstances.

Finally, it should be pointed out that in any particular case where both parties arguably assumed that a substantial amount of tax benefits would be attributable to deductions for losses on covered assets, and arguably agreed on

other forms of payment to the Government in lieu of specific tax benefit sharing, the aggrieved party could maintain that a change or clarification of the tax law affecting that agreement would warrant a modification to the related contractual provision. In this regard a clarification of the tax law -- by Congress or the IRS -- would not prevent an aggrieved party from pursuing any remedies that may be available as a matter of contract law, based upon the specific facts of the case.

Resolution Trust Corporation
Washington, DC 20434

L. William Seidman
Chairman

December 13, 1990

Dear Mr. Chairman:

Thank you for your letter forwarding written questions from Senator Kerry in connection with the hearing held on September 20, 1990. We are pleased to enclose responses to Senator Kerry's questions for inclusion in the record of the hearing.

We hope this information is useful. Please let me know if we can be of further assistance.

With best wishes.

Sincerely,

L. William Seidman
Chairman

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Enclosure

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KERRY FROM

L. WILLIAM SEIDMAN

Q.1. I have read that the American Savings Bank, sold to a group led by investor Robert Bass will cost the taxpayer over $4.8 billion, compared with an initial forecast of only $1.7. That is bad enough, but Mr. Bass, one of the richest people in this country, has made over $214 million on the deal -- better than a 50 percent return on an initial cash investment of $400 million. And then there is First Gibraltar bank owned by Ronald O. Perlman. In that 1988 deal, the bank was guaranteed $9.5 billion in federal assistance. In the first quarter of 1990 alone, the savings bank received $69.3 million of assistance on the $3.6 billion pool of problem assets it manages for the government. The thrift earned $28 million during that period.

Last week, you testified that renegotiating the 1988 sales of insolvent thrifts could yield billions of dollars for the federal government, but it would take even more billions in new spending before such savings could be realized. The American Banker reported that you "cryptically explained that for every $4 the government put today, it could net $1 off the total cost of the deals." Could you elaborate on this cryptic calculation?

A.1. As indicated in our Report to the Oversight Board of the Resolution Trust Corporation and the Congress on the 1988/89 Federal Savings and Loan Insurance Corporation Assistance Agreements, September 18, 1990, the following represents the basis for our calculations:

Potential Cost Reductions from the Unilateral Exercise of FSLIC Rights

Prepayment of FSLIC Notes	$1.1 to 1.2 billion
Prepayment of New West intercompany note	520 million
Prepayment of notes at government controlled institutions	*
Write-down of covered assets	535 million
Total	$2.2 to 2.3 billion

* - approximately $40 million per year; total depends on final resolution of the institutions under government control.

An additional budget outlay of approximately $5 billion in Fiscal Year 1991, to exercise unilateral rights to prepay notes (including the New West/American intercompany note) and mark covered assets to estimated fair market value, could potentially save the government as a whole $2.2 to $2.3 billion. The budgetary outlay is small relative to the potential savings due to the fact that the $16.6 billion in FSLIC promissory notes assumed to be prepaid have been scored for federal budget

purposes in the fiscal year in which they were issued. Accordingly, and more importantly, the cash needed to realize these savings would be approximately $18 to $20 billion in Fiscal Year 1991.

It is estimated that government-wide savings of an additional $1 to $2 billion could be realized from:

o purchase of selected covered assets;

o restructuring agreements through incentives to improve disposition rates and timing;

o total buy-out of smaller transactions; and

o reversal of current tax treatment with respect to the deductibility of built-in losses, where the government has compensated acquirors for their economic losses through capital loss payments.

Q.2. As you know Mr. Seidman, the former Chairman of the Federal Home Loan Bank Board, M. Danny Wall, claimed in 1988 that the thrift deals which merged or sold 223 insolvent institutions, would cost the government $39 billion. However, recent studies by the FDIC and the House Banking Committee indicate that the total cost of the '88 deals will be in the vicinity of $71 billion. I think we need to better understand how our government came to be placed in this terrible situation.

Who actually negotiated these deals for the government? Did Danny Wall himself actually participate in any of the negotiations? Were the negotiators assembled into teams -- how were the teams chosen? Was anyone from the Treasury Department involved at any time in the negotiations themselves or in the approval of these deals?

How were the deals negotiated -- describe for me the process? Did financiers such as Sid Bass and Ron Perlman approach the FHLBB or did the government contact these individuals as possible investors? Did staffers from the FHLBB suggest the huge tax breaks, which, I understand, Ron Perlman, among others, received? Perlman, for example, received tax benefits for the First Gibraltar that he can pass on to other companies he controls -- is that accurate? Who suggested that unusual arrangement, Perlman or the government?

Who was the highest official in the government to sign off the 1988 deals?

When did we first sense that the '88 deals may not have been good deals for the government? Who made the discovery?

A.2. The assertion that the government's estimate of the total cost of the 1988 assisted transactions has risen from $39 billion to $71 billion is simply not correct. There is an important distinction to be made between two very different measures of cost -- nominal dollar cost and present value cost -- which makes a simple comparison between the two grossly misleading. The original $39 billion estimate was measured in discounted present value dollars, meaning that it excluded the projected cost of interest payments over the life of the transactions. The original nominal dollar estimate of cost for the 1988 transactions was approximately $64 billion. This nominal dollar estimate included an interest cost calculation of roughly $25 billion.

As of June 30, 1990, the FDIC's nominal dollar cost estimate for the 1988 transactions was approximately $65 billion ($71 billion is our current nominal dollar estimate for all assisted transactions, not the 1988 transactions alone), less than 2 percent over the original nominal dollar estimate. This estimate may increase or decrease in response to such uncontrollable variables as interest rates, real estate markets, the availability of financing, and hazardous waste clean-up costs. While the cost may fluctuate, an increase of the magnitude suggested by the comparison of the original present value estimate to the current nominal dollar estimate is not anticipated.

The concept involved here is directly analogous to the difference between the current principal balance of a home mortgage and the total of principal and interest payments projected to be paid over the term of the mortgage. The distinction is crucial. With sufficient cash in hand today, one might either simply pay cash for the home to begin with or pay off an existing mortgage at its discounted present value (i.e. current principal balance plus any prepayment penalties that may apply). On the other hand, if sufficient cash is not available today and one must make principal and interest payments over the established amortization schedule, he or she will, over time, pay the nominal dollar cost which will, of course, be substantially higher because of interest paid on the loan.

With regard to the negotiation of these transactions, most of the former FHLBB and FSLIC senior officials who participated in the negotiations have left federal service altogether, making the job of responding to questions of this sort very difficult. It is our understanding, however, that primary responsibility for negotiating the non-Southwest Plan transactions rested with the Mergers and Acquisitions Division of the former FSLIC. Primary responsibility for negotiating the Southwest Plan transactions rested with the Southwest Plan Division of the former FSLIC. Negotiation efforts were overseen by the directors of these two divisions, the Deputy Executive Director for Case Resolutions, and the Executive Director of the FSLIC. All proposed

transactions were approved or disapproved by the former FHLBB, voting as a board.

Your question concerning Chairman Wall's direct participation in any negotiations should be directed to him since we do not have any first hand knowledge upon which to base a reply.

It is our understanding with regard to teams of negotiators that the former FHLBB and FSLIC did utilize teams composed of a lead negotiator and representatives from various offices within the FHLBB and FSLIC, as well as fee counsel. It is further our understanding that the Treasury Department did have knowledge of and consulted with the FHLBB regarding the availability to potential acquirors of certain tax benefits under existing law. The Treasury Department, however, was not involved in the negotiation or approval of the 1988 transactions.

The process by which the Southwest Plan transactions were negotiated was basically as follows. Pursuant to FHLBB Resolution 88-68, dated February 3, 1988, insolvent Texas thrifts were packaged by location and other criteria. Proposals on these packages were solicited generally. Potential acquirors, including primarily financial institutions but some non-financial institution investors as well, submitted bids in response to the general solicitation and/or were approached concerning their interest in being considered as an acquiror. Potential acquirors were evaluated based on written submissions and were either approved or disapproved as a potential acquiror by the Federal Home Loan Bank of Dallas.

Proposals from approved acquirors were simultaneously evaluated by the designated negotiator team. Through this process, approved acquirors for each package of failed thrifts were narrowed from as many as 60-70 down to the 2 or 3 offering the most favorable terms from the FHLBB/FSLIC's perspective. Negotiations and additional bid submissions further narrowed this field down to the one potential acquiror that, in the staff's opinion, was the most qualified and offered the best terms. A "board package" was then prepared in which the staff recommended that the FHLBB approve the sale of a particular package of failed thrifts to the potential acquiror determined to be the most qualified and offering the most favorable terms. The "board package" included not only the staff negotiator recommendation, but legal and regulatory analysis and concurrence in the recommendation, staff costings of the transaction, FHLB Dallas approval of the recommended acquiror as a potential acquiror, and all of the proposals submitted for a particular package which were not recommended for approval. Based on this "board package," the FHLBB would approve or disapprove the recommended acquisition. The process by which the non-Southwest Plan transactions were negotiated and approved was very similar.

With regard to the tax benefits, it was common knowledge that then existing law included special tax provisions for savings and loans receiving FSLIC assistance. These special provisions allowed for preferential treatment in the use of pre-acquisition attributes such as "built-in losses" and net operating loss carryforwards. The initial negotiating position of the FHLBB with respect to all transactions was stated in its term sheet as follows, "Standard tax benefit provision applied to all assistance payments. FSLIC will receive 100% of the NOLs of the surviving institution." Thus, the FHLBB began all negotiations with the position that to the extent an acquiror benefitted from any tax benefit derived from FSLIC assistance, such benefit was to be returned to the FSLIC. On some transactions, this position was relaxed during the course of negotiations.

The nominal dollar cost of the tax benefits to be received by First Gibraltar Bank, FSB (FGB) has been estimated at approximately $1.8 billion, net of nearly $700 million to be returned to the FDIC. Assistance paid by the FDIC to FGB is on an "after-tax" basis. The "after-tax" provisions of the assistance agreement with FGB provide that the tax benefits arising from FDIC assistance is netted from the assistance payment. The tax benefits to be received by the FDIC from FGB are defined as 10% of the assistance paid. Interest on notes, guaranteed yield, capital loss coverage, indemnification payments and certain other reimbursements are paid to FGB at 90% of the actual claim. In this manner, the FDIC receives immediate benefit for its share of the tax benefits arising from these payments. The assistance payments are tax-free to FGB.

In addition to the "after-tax" tax benefits, the FDIC also receives a net operating loss (NOL) tax benefit of 10% of the pre-acquisition NOL carryforwards utilized by FGB on its consolidated income tax return. We estimate, however, that no net operating loss carryforwards from pre-acquisition net operating losses will be utilized by FGB. Rather, we expect that FGB will utilize some of the net operating loss carryforwards for alternative minimum tax purposes and the FGB assistance agreement does not provide for the FDIC to share tax benefits arising from alternative minimum taxes. As a final note, the assistance agreement does provide a guarantee from FGB that the total tax benefits, "after-tax" and NOL as described above, will be at least $300 million for the 10-year term of the assistance agreement.

The former FHLBB, voting as a Board, was the highest government entity to approve the 1988 transactions.

With regard to whether or not the 1988 transactions were good deals for the government, as stated before, when you have, as the FHLBB did, no cash, doubtful credit, and an imposed deadline for completing a transaction, you are going to pay through the nose. There is no question that these were expensive transactions, but

the suggestion that they may not be good deals for the government necessitates a comparison with the alternatives. The real question is whether the FHLBB should have undertaken the transactions at all. Given that it had no cash and doubtful credit, there were only two options available to the FHLBB during 1988 -- either pursue the course it did or suspend case resolutions and further press Congress for funding. For its own reasons, it chose the former and, in doing so, was statutorily obligated to pursue assisted acquisitions only if the cost was demonstrated to be less than the cost of liquidation. In each instance, the FHLBB determined that this was the case.

As explained elsewhere in this response, the recently completed RTC cost review of the 1988 transactions has identified long-term savings of $2-$4 billion that can be achieved through substantial short-term expenditures to exercise existing contractual options and renegotiate certain provisions. Funding for this and other purposes was appropriated by Congress on October 26, 1990. A second RTC study specifically focusing on the bidding and negotiating procedures used for the 1988 transactions is expected to be completed by the end of this month.

Q.2.a. From the days when Danny Wall headed the FHLBB, what have you done to enhance the ability of our government to negotiate thrift buyouts? How have you been able to attract high quality staff? What can you do to assure the Committee that you are employing the most up to date methods of financial analysis (presumedly different from the kind of financial analysis that Danny Wall used).

A.2.a. In general, the biggest change has been in the methodology of marketing thrift franchises. Whereas previously the FHLBB used extensive amounts of one-on-one negotiating, the RTC utilizes a more open, competitive bidding process. That is, in advance of each sale, the RTC structures one or more alternative transactions complete with legal documents, pro formas, bid packages etc., and invites qualified acquirors to conduct due diligence at the target institution. Sealed bids using the prescribed formats are then evaluated using an internally developed cost test model (see Attachment 1 for a copy of the output). Inputs to the model include information from the institution (in conservatorship under RTC control), the bid package and a valuation of all the assets as estimated by an independent contractor employed by the RTC. With the transaction structured in such a fashion, there is little chance of not selecting the "best bid" since competitive marketing has taken place and all bids are in a consistent, comparable format.

Much of the senior management of the RTC's Resolutions Division has been drawn from individuals at the FDIC that have had extensive prior experience with closing banks, assistance transactions, and asset collections and valuations. The overall quality of the staff that has been assembled is first rate and is

able to deal with all problems effectively. Finally, there is now a clear policy surrounding these transactions that the cost to the taxpayer is the ultimate concern and not cash flow and related constraints of the old FSLIC that may have led to gimmickry in terms of stretching financial analysis to meet inappropriate constraints or considerations.

Q.3. None of the deals ended or even limited the government's exposure to mismanagement by the new owners, hidden losses on real estate in the past or the vicissitudes of the real estate market in the future. The future losses keep growing with each new downturn in real estate markets and could deepen much faster in a recession. And some of the deals appear to be sham transactions in which failing thrifts were sold to failing thrifts, which are failing all over again.

Mr. Seidman, I read yesterday that you are reluctant to comment on whether or not it is appropriate to spend money now for cost cutting measures, especially considering the growing deficit -- that you believe this is a decision that must be made by Congress and the Administration. Nevertheless, you are the Chairman of the Resolution Trust Corporation and I'd like to hear your recommendation: Do you believe it is more cost effective to spend the money now or should the government take a long term hit?

A.3. Generally, I believe it is more cost effective for the government to spend the money now to prepay FSLIC notes where the terms of the agreement allow prepayment, and the rates paid by the Treasury to raise funds for prepayment are less than the rates paid on the FSLIC notes. In making the decision to prepay FSLIC notes or to repurchase covered assets in order to save carrying costs the government must be careful to weigh the added risk to the RTC that such strategy will cause. In many situations, the overhead costs of operating inefficient retail deposit gathering branch networks acquired from failed institutions are substantial. Also, in many areas of the country demand for good quality loans is weak. If some thrifts are provided with large amounts of cash from the prepayment of notes or purchase of covered assets they will be required to make risky investments to cover their costs. Therefore, a strategy of prepaying notes and repurchasing covered assets could backfire and result in additional costly thrift failures. The RTC will be careful to weigh the potential added costs before prepayment and repurchase decisions are made.

Q.3.a. Mr. Seidman I'm sure that you saw the Op/Ed by Lawrence White and Edward Golding on how the RTC could save $800 million -- those two gentlemen suggest that the government could save $800 [million] simply refinancing FSLIC notes, currently at 9.5 percent with Treasury notes at 8.2 percent. According to White and Golding the transaction would mean an "immediate annual cost savings for about 1.2 percent on the full $20 billion, or $240

million a year." Furthermore, they contend that the substitution would create a tax windfall for the government as FSLIC notes are tax-free investments. Taxes on the 8.2 percent interest on the $20 billion of treasury bills, at the corporate tax rate of 34 percent, would amount to $560 million a year. Has the RTC looked into the feasibility of this proposal?

A.3.a. A significant portion of the RTC's report dated September 18, 1990 discussed the strategy to which you refer. The RTC study summarized the conclusions drawn by its contractors that approximately $1.1 to $1.2 billion in present value terms could be saved by prepaying approximately $11.3 billion in FSLIC notes. The RTC's figure includes potential savings from the conversion of tax free income to taxable income. The tax consequences to the acquirors from the repayment of FSLIC notes and the difficulty of precisely estimating this benefit were also discussed.

Q.4. One of Mr. Wall's apparent miscalculations was that he excluded $9 billion of tax benefits given the new buyers. Could you describe for the taxpayer the nature of these tax benefits? (tax-loss carry forward deductions and tax free financial aid) Why is it not possible to simply rescind those benefits or to levy a narrow windfall profits tax on the thrifts?

A.4. The general nature of the tax benefits is just as you have described them. Payments made under the assistance agreements are tax-free to the acquiror in that they are exempted from income. In addition, certain acquirors may be able to use net operating loss carryforwards from pre-acquisition net operating losses to shelter a portion of the holding company's income equal to the amount of income contributed to the holding company, if any, by the operations of the resulting thrift. Further, any post-acquisition losses recognized on acquired assets, including "built-in losses," may be used to offset the income of the holding company without the limitation imposed on pre-acquisition NOLs.

The total nominal dollar cost of the tax benefits arising under the 1988 transactions was estimated in February 1989 to be approximately $8.5 billion, of which about $4.3 billion will flow back to the FDIC. The net cost of the tax benefits to the U.S. government, therefore, is approximately $4.2 billion. This estimated loss of revenue to the Treasury was not included as a cost of the transactions because the revenue loss arose not from the assistance agreements but from then existing tax law and therefore was not a cost to the FSLIC Insurance Fund (now the FSLIC Resolution Fund). The FHLBB was statutorily required to demonstrate only that the cost to the FSLIC Insurance Fund of an assisted transaction was less than the cost of liquidation. It was not required to consider loss of tax revenue to the Treasury.

Your question regarding feasibility of rescinding these tax benefits is more appropriately directed to the Treasury Department. Such a decision, however, may negatively impact the future ability of the RTC to resolve failed thrifts. In some cases, the provisions of assistance agreements may require the FDIC to reimburse acquirors for such changes in tax law.

Q.5. My understanding is that the FDIC is suing the big eight accounting firms? Does it make sense to seek settlement with these firms and as a part of the settlement to require those firms to lend their expertise to the RTC? How much is the government seeking in its suits and what are the legal fees the government is incurring?

A.5. The FDIC and the RTC are currently litigating accounting malpractice claims against the following Big Six firms: Coopers & Lybrand, Arthur Anderson, Ernst & Young, Peat Marwick Main, Deloitte, Haskins & Sells (merged with Touche Ross), J.K. Byrne (merged with Touche Ross) and Touche Ross & Co. Attached is a complete list of lawsuits pending against these firms, including the approximate damages sought in each complaint. Damages sought in the attached claims total approximately $2 billion (Attachment 2).

Although the FDIC and RTC are always willing to consider, and have accepted, reasonable offers of settlement in connection with accounting malpractice and other professional liability claims, in kind contributions of services have not been sought as a condition of settlement. Our very limited experience suggests that in kind contributions of services are not desirable in the settlement context on a consistent basis. Although we do not wish to preclude the possibility that such settlement conditions would be acceptable to the FDIC or RTC in a particular case, serious questions are raised concerning the benefit of such contributions from accounting firms named as defendants in suits involving allegations and evidence of accounting malpractice.

It is difficult to estimate the legal fees and expenses incurred to date on this group of claims due the different ways in which such records were kept prior to the merger of the former FSLIC with the FDIC, but we believe that approximately $25 million have been expended to date. We anticipate that substantial additional expenditures will be incurred in order to effectively prosecute such claims. Although it also is difficult to predict a precise figure for future legal costs in cases of this kind, we expect that additional expenditures may total two to three times the amounts already incurred if all the accountants claims proceed through trial.

Attachment 1

REPORT A

24-Sep-90 06:41 PM

INSTITUTION: ARLINGTON HEIGHTS SA FIN: 8281

LOCATION: ARLINGTON HEIGHTS, IL DATE OF DATA: 05/31/90

DEPOSITOR PREFERENCE STATE: NO

LIQUIDATION SUMMARY STATEMENT AND DISTRIBUTION OF LOSS

(in 000's)

	Assets		Liabilities (Not Subordinated)	
1A	Cash and Securities	109,507	15A Sec./Pref. Deposits	95
2A	Residential Loans	235,040	16A Insured Deposits	356,790
3A	Consumer Loans	10,685	17A Uninsured Deposits	355
4A	Other Loans	8,861		
5A	Real Estate Owned	5,198	18A Total Deposits	357,240
6A	Other Assets	16,460	19A Sec./Pref. Liab.	50,680
			20A Other Liabilities	1,732
7A	Book Assets	385,751	21A Book Liabilities	409,652
8A	Non-book Assets	0	22A Non-book Liab.-Sec.	0
9A	RTC M-T-M Asset Loss	(21,633)	23A Non-book Liab.-Others	0
10A	Adjusted Assets	364,118	24A Adjusted Liabilities	409,652
11A	Sec./Pref. Claims	(50,775)	25A Sec./Pref. Claims	(50,775)
12A	Available Assets	313,343	26A Claims	358,877
13A	Total Loss - Sr. Claims	45,534	27A Junior Claims *	0
14A	Proof	358,877	28A Net Senior Claims	358,877

PRO-RATA DISTRIBUTION OF LOSS AND RECOVERY IN LIQUIDATION

		NET CLAIMS	% OF SR. CLAIMS	EXPECTED LOSS	EXPECTED RECOVERY
29A	RTC for Insured Deposits	356,790	99.4185%	45,269 **	311,521
30A	Uninsured Deposits	355	0.0989%	45	310
31A	Other Creditors	1,732	0.4826%	220	1,512
		358,877	100.0000%	45,534	313,343

* Applies only in depositor preference states.
** Represents cost of payoff and maximum acceptable RTC loss in P&A transaction.

REPORT B 24-Sep-90 06:41 PM

INSTITUTION: ARLINGTON HEIGHTS SA FIN: 8281

LOCATION: ARLINGTON HEIGHTS, IL DATE OF DATA: 05/31/90

TRANSACTION SUMMARY

(in 000's)

		BASE P&A	BASE W/OPT	WHOLE BANK
1B	Liabilities Assumed	360,919	360,919	409,652
2B	Original BV of Assets Acquired	301,141	312,765	368,999
3B	Gross Cash to Acquiror	59,778	48,154	40,653
4B	Add: RTC Advances	0	0	0
5B	Gross RTC Funding	59,778	48,154	40,653
6B	Asset Retained by RTC	84,610	72,986	16,752
7B	Loss on Retained Assets	(11,481)	(11,211)	(8,758)
8B	Net Recovery on Retained Assets	73,129	61,775	7,994

RTC COST SUMMARY

	Best Bidder by Option type	Citibank	NBD	World
10B	Gross Cash to Acquiror	59,778	48,154	40,653
11B	Recovery on Retained Assets	(73,129)	(61,775)	(7,994)
12B	Adj. to BV per P&A Agreement	8,296	8,873	8,152
13B	RTC Advances	0	0	0
14B	Payment on Put Assets	55,362	64,839	0
15B	Recovery on Put Assets	(52,330)	(61,776)	0
16B	Dist. to Oth. Creditors (Sec./Unsec.)	48,659	48,659	0
17B	Bid Amount	(25,100)	(24,356)	(500)
18B	Cost of Proposed Transaction	21,536	22,618	40,311
19B	Cost to RTC of Payoff	(45,269)	(45,269)	(45,269)
20B	Savings over Payoff	23,733	22,651	4,958
21B	BIF/SAIF Adjustment	0	0	0
22B	Savings after Adjustment	23,733	22,651	4,958
23B	Uninsured Deposits - Share of Loss	45	45	45
24B	Actual or Implied Premium	23,778	22,696	5,003

REPORT D1

24-Sep-90
06:41 PM

(NON-DEPOSITOR PREFERENCE STATE ONLY)

INSTITUTION:
ARLINGTON HEIGHTS SA
LOCATION:
ARLINGTON HEIGHTS, IL

FIN: 8281
DATE OF DATA: 05/31/90

(in 000's)

COST TEST

101	Total Deposits (Incl. Accrued Int.)	357,240		
	Plus Other Liabilities:			
201	Secured Borrowings	45,000		
301	Unsecured Borrowings	0		
401	Secured Liabilities	78		
501	Accrued Other Expenses	515		
601	Prefered Liabilities	5,602		
701	Other Liabilities	1,217		
801	Total Booked Liabilities		409,652	
901	Est. Loss in Contingent & Non-Booked Liab.: Secured	0		
	Unsecured	0		
1001	Total Liabilities		409,652	
	Less:			
1101	Secured Deposits	0		
1201	Preferred Deposits	95		
1301	Secured Borrowings	45,000		
1401	Secured Liabilities	78		
1501	Preferred Liabilities	5,602		
1601	NET TOTAL LIABILITIES		358,877 (A)	
1701	Gross Book Assets	385,751		
1801	Plus: Non-Booked Assets	0		
1901	Gross Assets	385,751		
	Less:			
2001	N-T-M Loss Estimate	21,633		
2101	Secured and Preferred Deposits	95		
2201	Secured and Preferred Liab.	50,680		
2301	NET FREE ASSETS		313,343 (B)	
2401	TOTAL LOSS (A - B)		45,534 (C)	
2501	Total Deposits	357,240		
	Less:			
2601	Uninsured Deposits	355 (D)		
2701	Secured Deposits	0		
2801	Preferred Deposits	95		
2901	Total Insured Liabilities	356,790 (E)		

3001	RTC PERCENTAGE (E/A)	99.4185%(F)	
3101	PRO RATA LOSS RATIO (C/A)	12.6879%(G)	
3201	RTC SHARE OF LOSS (C*F)	45,269	
3301	Premium Needed for Transfer of Uninsured Deposits (D*G)		45
3401	I- Assets Transferred in Excess of RTC N-T-M	1,856	
3501	Loss in Transferring Deposits at Par	(45)	
3601	Estimated Loss on Potential Asset Puts	(3,032)	
3701	MAXIMUM DISCOUNT FOR BASE P&A		(1,221)
3801	II- Assets Transferred in Excess of RTC N-T-M	1,549	
3901	Loss in Transferring Deposits at Par	(45)	
4001	Estimated Loss on Potential Asset Puts	(3,063)	
4101	MAXIMUM DISCOUNT FOR BASE P&A W/OPTIONS		(1,559)
4201	III- Assets Transferred in Excess of RTC N-T-M	4,723	
4301	Loss in Transferring Deposits at Par	(45)	
4401	Estimated Loss on Potential Asset Puts	0	
4501	MAXIMUM DISCOUNT FOR ALT #2 P&A		4,678
4601	IV- Assets Transferred in Excess of RTC N-T-M	0	
4701	Loss in Transferring Deposits at Par	(45)	
4801	Estimated Loss on Potential Asset Puts	0	
4901	MAXIMUM DISCOUNT FOR ALT #3 P&A		(45)
5001	Unsecured Liabilities Retained (H)	1,732	
5101	Estimated Loss on Receivership Cert. (G*H)	220	
5201	PRO RATA DISTRIBUTION TO CREDITORS		1,512

5301	SECURED/PREFERRED LIABILITIES RETAINED - STD. P&A	47,147
	- ALT #1	47,147
	- ALT #2	2,147
	- ALT #3	47,225

REPORT E

24-Sep-90
06:41 PM

PROPOSED BID STRUCTURE AND RELATED RTC M-T-M LOSS DATA

INSTITUTION: ARLINGTON HEIGHTS SA FIN: 8281

LOCATION: ARLINGTON HEIGHTS, IL DATE OF DATA: 05/31/90

(In 000's)

	ALTERNATIVE	ASSETS PASSING TO ACQUIROR: BOOK VALUE	ASSETS PASSING TO ACQUIROR: RTC M-T-M VALUE	ASSETS PASSING TO ACQUIROR: BOOK VALUE	ASSETS PASSING TO ACQUIROR: RTC M-T-M VALUE	ASSETS PASSING TO ACQUIROR: TRANSFER VALUE	ASSETS RETAINED BY RTC: BOOK VALUE	ASSETS RETAINED BY RTC: RTC M-T-M VALUE	PAYMENT ON PUT ASSETS	RECOVERY ON PUT ASSETS	EST. LOSS ON PUT ASSETS
	BASE P&A										
1E	Cash and Securities	109,507	107,384	59,065	59,065	59,065	50,442	48,319	0	0	0
2E	Residential Loans	235,040	224,753	228,371	218,248	220,628	6,669	6,505	55,362	52,330	3,032
3E	Consumer Loans	10,685	10,656	10,685	10,656	10,132	0	0	0	0	0
4E	Other Loans	8,861	8,756	0	0	0	8,861	8,756	0	0	0
5E	Real Estate Owned	5,198	2,400	0	0	0	5,198	2,400	0	0	0
6E	Other Assets	16,460	10,169	3,020	3,020	3,020	13,440	7,149	0	0	0
7E	Total Assets	385,751	364,118	301,141	290,989	292,865	84,610	73,129	55,362	52,330	3,032
8E	Assets transferred in excess of RTC M-T-M Value.....					1,856					
	BASE W/OPT										
9E	Cash and Securities	109,507	107,384	59,065	59,065	59,065	50,442	48,319	0	0	0
10E	Residential Loans	235,040	224,753	231,040	220,752	223,163	4,000	4,001	57,263	54,200	3,063
11E	Consumer Loans	10,685	10,656	10,685	10,656	10,132	0	0	0	0	0
12E	Other Loans	8,861	8,756	8,861	8,756	8,418	0	0	7,576	7,576	0
13E	Real Estate Owned	5,198	2,400	0	0	0	5,198	2,400	0	0	0
14E	Other Assets	16,460	10,169	3,114	3,114	3,114	13,346	7,055	0	0	0
15E	Total Assets	385,751	364,118	312,765	302,343	303,892	72,986	61,775	64,839	61,776	3,063
16E	Assets transferred in excess of RTC M-T-M Value.....					1,549					

(continued)

PROPOSED BID STRUCTURE AND RELATED RTC M-T-M LOSS DATA

INSTITUTION: ARLINGTON HEIGHTS SA FIN: 6281

LOCATION: ARLINGTON HEIGHTS, IL DATE OF DATA: 05/31/90

(in 000's)

ALTERNATIVE	ASSETS PASSED TO ACQUIROR: BOOK VALUE	ASSETS PASSED TO ACQUIROR: RTC M-T-M VALUE	ASSETS PASSED TO RTC: BOOK VALUE	ASSETS PASSED TO RTC: RTC M-T-M VALUE	PAYMENT ON PUT ASSETS	RECOVERY ON PUT ASSETS	EST. LOSS ON PUT ASSETS
WHOLE BANK							
17E Cash and Securities	109,507	107,384	104,106	104,112	104,112	5,401	3,272	0	0	0
18E Residential Loans	235,040	224,753	235,040	224,752	228,058	0	1	0	0	0
19E Consumer Loans	10,685	10,656	10,685	10,656	10,685	0	0	0	0	0
20E Other Loans	8,361	8,756	8,861	8,756	8,861	0	0	0	0	0
21E Real Estate Owned	5,198	2,400	0	0	0	5,198	2,400	0	0	0
22E Other Assets	16,460	10,169	10,307	7,848	9,131	6,153	2,321	0	0	0
23E Total Assets	385,751	364,118	368,999	356,124	360,847	16,752	7,994	0	0	0
24E Assets transferred in excess of RTC M-T-M Value.....					4,723					

Schedule E1

Arlington Heights, IL
FIN 8281

Base P&A

	BV	MTM	TV	PUT	RECOVER	LOSS
Residential:						
1-4s						
Fixed	91,322		87,500			
Adj	122,627		119,469			
Total	213,949	203,937	206,969	55,362	52,330	3,032
2nd Mort	14,422	14,311	13,659	0	0	0
Total Resid.	228,371	218,248	220,628	55,362	52,330	3,032

Base W/Opt

	BV	MTM	TV	PUT	RECOVER	LOSS
Residential:						
1-4s						
Fixed	91,322		87,500			
Adj	122,627		119,469			
Total	213,949	203,937	206,969	55,362	52,330	3,032
2nd Mort	14,422	14,311	13,659	0	0	0
Subtotal	228,371	218,248	220,628	55,362	52,330	3,032
Other Resid.	2,669	2,504	2,535	1,901	1,870	31
Total Resid.	231,040	220,752	223,163	57,263	54,200	3,063

REPORT F

24-Sep-90
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INSTITUTION: ARLINGTON HEIGHTS SA FIN: 6281

LOCATION: ARLINGTON HEIGHTS, IL DATE OF DATA: 05/31/90

SUMMARY OF BIDS
RANKED AFTER BIF/SAIF ADJUSTMENT
(in 000's)

BASE P&A	BIF OR SAIF	AMOUNT OF BID	BID AFTER ADJUSTMENT	RTC COST	RTC SAVINGS OVER PAYOFF	SAVINGS LESS BIF ADJUSTMENT
Citibank FSB	SAIF	25,100	25,100	21,336	23,733	23,733
Household Bank FSB	SAIF	12,354	12,354	34,282	10,987	10,987
American HB Ari Hts	BIF	10,610 *	10,610	36,026	9,243	9,243
BASE W/CPT						
HBD Ari Hts Bk	BIF	24,356 *	24,356	22,618	22,651	22,651
Old Kent Bank, MA	BIF	13,050 *	13,050	33,924	11,345	11,345
WHOLE BANK						
World SELA, FSBLA	SAIF	500	500	40,311	4,958	4,958
ALT 2						

NOTE: BIF bid is adjusted adversely by $0 BIF/SAIF adjustment factor.

REPORT G

PRO FORMA BALANCE SHEET
(in 000's)

24-Sep-90
06:41 PM

INSTITUTION: ARLINGTON HEIGHTS SA
LOCATION: ARLINGTON HEIGHTS, IL
DEPOSITOR
PREF. STATE: NO

FIN: 8281
DATE OF DATA: 05/31/90
BID OPTION: BASE P&A

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
	ASSETS (Gross Book Value)			
1G	Cash & Inv. Sec.:			
	Cash & Due From Banks	$44,549	$0	$44,549
	Mortgage Pool Securities	$59,516	$45,000	$14,516
	Investment Securities	$41	$41	$0
	Other Securities	$5,401	$5,401	$0
	Acc. Int. Rec. - Securities	$0	$0	$0
	Total	$109,507	$50,442	$59,065
2G	Mortgage Loans:			
	1-4 Family Res.:			
	Performing Adj. Rate	$121,286	$0	$121,286
	Performing Fixed Rate	$95,322	$4,000	$91,322
	30-59 Days Delinquent	$623	$0	$623
	60-89 Days Delinquent	$324	$0	$324
	90+ Del. & Nonaccrual	$394	$0	$394
	Total	$217,949	$4,000	$213,949
3G	2nd Mortgage Loans:			
	Performing	$14,307	$0	$14,307
	30-59 Days Delinquent	$18	$0	$18
	60-89 Days Delinquent	$23	$0	$23
	90+ Del. & Nonaccrual	$74	$0	$74
	Total	$14,422	$0	$14,422
4G	Other Residential:			
	Performing	$2,669	$2,669	$0
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$2,669	$2,669	$0
5G	Construction Loans:			
	Performing	$1,121	$1,121	$0
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$1,121	$1,121	$0

REPORT G continued $33,141 $33,141
FIN: 8281
OPTION: BASE P&A

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
6G	Land Loans:			
	Performing	$1,426	$1,426	$0
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$1,426	$1,426	$0
7G	Other:			
	Performing	$5,781	$5,781	$0
	30-59 Days Delinquent	$221	$221	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$6,002	$6,002	$0
	Non-Mortgage Loans:			
8G	Consumer:			
	Performing	$10,584	$0	$10,584
	30-59 Days Delinquent	$62	$0	$62
	60-89 Days Delinquent	$7	$0	$7
	90+ Del. & Nonaccrual	$32	$0	$32
	Total	$10,685	$0	$10,685
9G	Commercial:			
	Performing	$312	$312	$0
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$312	$312	$0
10G	Real Estate:			
	Real Estate Owned	$5,198	$5,198	$0
	Other Real Estate	$0	$0	$0
	Total	$5,198	$5,198	$0
11G	Subsidiaries:			
	Equity Investment	$175	$175	$0
	Unsecured Loans	$1,954	$1,954	$0
	Total	$2,129	$2,129	$0
12G	Fixed Assets:	$4,024	$4,024	$0

REPORT G continued
FIN: 8281
OPTION: BASE P&A

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
13G	Other Assets:			
	Prepaid Fees	$2,176	$2,176	$0
	Intangible Assets	$1,534	$1,534	$0
	FHLB Stock	$3,469	$3,469	$0
	Accrued Interest Receivable	$3,114	$94	$3,020
	Other	$14	$14	$0
	Total	$10,307	$7,287	$3,020
14G	TOTAL ASSETS	$385,751	$84,610	$301,141
	LIABILITIES:			
15G	Total Deposits	$357,240	$0	$357,240
16G	FHLB Advances	$0	$0	$0
17G	RTC Advances	$0	$0	$0
18G	Secured Borrowings	$45,000	$45,000	$0
19G	Secured Liabilities	$78	$0	$78
20G	Unsecured Borrowings	$0	$0	$0
21G	Accrued Other Expenses	$515	$369	$146
22G	Other Liabilities	$6,819	$3,364	$3,455
23G	Total Liabilities	$409,652	$48,733	$360,919
24G	Net Worth	($23,901)	$35,877	($59,778)
25G	TOTAL LIABILITIES & EQUITY	$385,751	$84,610	
26G	Gross Cash to Acquiror	NA	NA	$59,778
	Plus RTC Advances	NA	NA	$0
	Gross RTC Funding	NA	NA	$59,778

****
Notes:

REPORT G continued 24-Sep-90 06:41 PM
FIN: 8281
OPTION: BASE P&A

MEMO ITEMS:

27G	General & Specific Reserves	$2,239
28G	Total Deposits <$80,000	$329,075
29G	Brokered Deposits <$80,000	$0
30G	Total Brokered Deposits	$0
31G	Secured Deposits	$0
32G	Preferred Deposits	$95
33G	Insured Deposits	$356,790
34G	Uninsured Deposits	$355
35G	Preferred Liabilities	$5,602

36G ESTIMATED LOSS IN CONTINGENT & NON-BOOKED LIABILITIES:

Secured Borrowings	0
Secured Liabilities	0
Total Secured	$0
Unsecured Borrowings	0
Unsecured Accrued Expenses	0
Unsecured Other Liabilities	0
Total Unsecured	$0

37G NON-BOOKED ASSETS:

- Cash & Securities	0
- Residential Loans	0
- Consumer Loans	0
- Other Loans	0
- Real Estate Owned	0
- Other Assets	0
Total	$0

38G	# of Branches	5
39G	# of Deposit Accounts	62,422
40G	RTC M-T-M Loss	$21,633

****
Notes:

REPORT G

PRO FORMA BALANCE SHEET
(in 000's)

24-Sep-90
06:41 PM

INSTITUTION: ARLINGTON HEIGHTS SA
LOCATION: ARLINGTON HEIGHTS, IL
DEPOSITOR
PREF. STATE: NO

FIN: 8281
DATE OF DATA: 05/31/90
BID OPTION: BASE W/OPT

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
	ASSETS (Gross Book Value)			
1G	Cash & Inv. Sec.:			
	Cash & Due From Banks	$44,549	$0	$44,549
	Mortgage Pool Securities	$59,516	$45,000	$14,516
	Investment Securities	$41	$41	$0
	Other Securities	$5,401	$5,401	$0
	Acc. Int. Rec. - Securities	$0	$0	$0
	Total	$109,507	$50,442	$59,065
2G	Mortgage Loans:			
	1-4 Family Res.:			
	Performing Adj. Rate	$121,286	$0	$121,286
	Performing Fixed Rate	$95,322	$4,000	$91,322
	30-59 Days Delinquent	$623	$0	$623
	60-89 Days Delinquent	$324	$0	$324
	90+ Del. & Nonaccrual	$394	$0	$394
	Total	$217,949	$4,000	$213,949
3G	2nd Mortgage Loans:			
	Performing	$14,307	$0	$14,307
	30-59 Days Delinquent	$18	$0	$18
	60-89 Days Delinquent	$23	$0	$23
	90+ Del. & Nonaccrual	$74	$0	$74
	Total	$14,422	$0	$14,422
4G	Other Residential:			
	Performing	$2,669	$0	$2,669
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$2,669	$0	$2,669
5G	Construction Loans:			
	Performing	$1,121	$0	$1,121
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$1,121	$0	$1,121

REPORT G continued 24-Sep-90 06:41 PM
FIN: 8281
OPTION: BASE W/OPT

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
6G	Land Loans:			
	Performing	$1,426	$0	$1,426
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$1,426	$0	$1,426
7G	Other:			
	Performing	$5,781	$0	$5,781
	30-59 Days Delinquent	$221	$0	$221
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$6,002	$0	$6,002
	Non-Mortgage Loans:			
8G	Consumer:			
	Performing	$10,584	$0	$10,584
	30-59 Days Delinquent	$62	$0	$62
	60-89 Days Delinquent	$7	$0	$7
	90+ Del. & Nonaccrual	$32	$0	$32
	Total	$10,685	$0	$10,685
9G	Commercial:			
	Performing	$312	$0	$312
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$312	$0	$312
10G	Real Estate:			
	Real Estate Owned	$5,198	$5,198	$0
	Other Real Estate	$0	$0	$0
	Total	$5,198	$5,198	$0
11G	Subsidiaries:			
	Equity Investment	$175	$175	$0
	Unsecured Loans	$1,954	$1,954	$0
	Total	$2,129	$2,129	$0
12G	Fixed Assets:	$4,024	$4,024	$0

REPORT G continued
FIN: 8281
OPTION: BASE W/OPT

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
13G	Other Assets:			
	Prepaid Fees	$2,176	$2,176	$0
	Intangible Assets	$1,534	$1,534	$0
	FHLB Stock	$3,469	$3,469	$0
	Accrued Interest Receivable	$3,114	$0	$3,114
	Other	$14	$14	$0
	Total	$10,307	$7,193	$3,114
14G	TOTAL ASSETS	$385,751	$72,986	$312,765
	LIABILITIES:			
15G	Total Deposits	$357,240	$0	$357,240
16G	FHLB Advances	$0	$0	$0
17G	RTC Advances	$0	$0	$0
18G	Secured Borrowings	$45,000	$45,000	$0
19G	Secured Liabilities	$78	$0	$78
20G	Unsecured Borrowings	$0	$0	$0
21G	Accrued Other Expenses	$515	$369	$146
22G	Other Liabilities	$6,819	$3,364	$3,455
23G	Total Liabilities	$409,652	$48,733	$360,919
24G	Net Worth	($23,901)	$24,253	($48,154)
25G	TOTAL LIABILITIES & EQUITY	$385,751	$72,986	
26G	Gross Cash to Acquiror	NA	NA	$48,154
	Plus RTC Advances	NA	NA	$0
	Gross RTC Funding	NA	NA	$48,154

****
Notes:

REPORT G continued 24-Sep-90 06:41 PM
FIN: 8281
OPTION: BASE W/OPT

MEMO ITEMS:

27G	General & Specific Reserves	$2,239
28G	Total Deposits <$80,000	$329,075
29G	Brokered Deposits <$80,000	$0
30G	Total Brokered Deposits	$0
31G	Secured Deposits	$0
32G	Preferred Deposits	$95
33G	Insured Deposits	$356,790
34G	Uninsured Deposits	$355
35G	Preferred Liabilities	$5,602

36G ESTIMATED LOSS IN CONTINGENT & NON-BOOKED LIABILITIES:

Secured Borrowings	0
Secured Liabilities	0
Total Secured	$0
Unsecured Borrowings	0
Unsecured Accrued Expenses	0
Unsecured Other Liabilities	0
Total Unsecured	$0

37G NON-BOOKED ASSETS:

- Cash & Securities	0
- Residential Loans	0
- Consumer Loans	0
- Other Loans	0
- Real Estate Owned	0
- Other Assets	0
Total	$0

38G	# of Branches	5
39G	# of Deposit Accounts	62,422
40G	RTC M-T-M Loss	$21,633

****
Notes:

REPORT G

24-Sep-90
06:41 PM

PRO FORMA BALANCE SHEET
(in 000's)

INSTITUTION: ARLINGTON HEIGHTS SA
LOCATION: ARLINGTON HEIGHTS, IL
DEPOSITOR
PREF. STATE: NO

FIN: 8281
DATE OF DATA: 05/31/90
BID OPTION: WHOLE BANK

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
	ASSETS (Gross Book Value)			
1G	Cash & Inv. Sec.:			
	Cash & Due From Banks	$44,549	$0	$44,549
	Mortgage Pool Securities	$59,516	$0	$59,516
	Investment Securities	$41	$0	$41
	Other Securities	$5,401	$5,401	$0
	Acc. Int. Rec. - Securities	$0	$0	$0
	Total	$109,507	$5,401	$104,106
2G	Mortgage Loans:			
	1-4 Family Res.:			
	Performing Adj. Rate	$121,286	$0	$121,286
	Performing Fixed Rate	$95,322	$0	$95,322
	30-59 Days Delinquent	$623	$0	$623
	60-89 Days Delinquent	$324	$0	$324
	90+ Del. & Nonaccrual	$394	$0	$394
	Total	$217,949	$0	$217,949
3G	2nd Mortgage Loans:			
	Performing	$14,307	$0	$14,307
	30-59 Days Delinquent	$18	$0	$18
	60-89 Days Delinquent	$23	$0	$23
	90+ Del. & Nonaccrual	$74	$0	$74
	Total	$14,422	$0	$14,422
4G	Other Residential:			
	Performing	$2,669	$0	$2,669
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$2,669	$0	$2,669
5G	Construction Loans:			
	Performing	$1,121	$0	$1,121
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$1,121	$0	$1,121

REPORT G continued 24-Sep-90 06:41 PM
FIN: 8281
OPTION: WHOLE BANK

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
6G	Land Loans:			
	Performing	$1,426	$0	$1,426
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$1,426	$0	$1,426
7G	Other:			
	Performing	$5,781	$0	$5,781
	30-59 Days Delinquent	$221	$0	$221
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$6,002	$0	$6,002
	Non-Mortgage Loans:			
8G	Consumer:			
	Performing	$10,584	$0	$10,584
	30-59 Days Delinquent	$62	$0	$62
	60-89 Days Delinquent	$7	$0	$7
	90+ Del. & Nonaccrual	$32	$0	$32
	Total	$10,685	$0	$10,685
9G	Commercial:			
	Performing	$312	$0	$312
	30-59 Days Delinquent	$0	$0	$0
	60-89 Days Delinquent	$0	$0	$0
	90+ Del. & Nonaccrual	$0	$0	$0
	Total	$312	$0	$312
10G	Real Estate:			
	Real Estate Owned	$5,198	$5,198	$0
	Other Real Estate	$0	$0	$0
	Total	$5,198	$5,198	$0
11G	Subsidiaries:			
	Equity Investment	$175	$175	$0
	Unsecured Loans	$1,954	$1,954	$0
	Total	$2,129	$2,129	$0
12G	Fixed Assets:	$4,024	$4,024	$0

REPORT G continued
FIN: 6281
OPTION: WHOLE BANK

		ACTUAL	RETAINED BY RTC	PASSED TO ACQUIROR
13G	Other Assets:			
	Prepaid Fees	$2,176	$0	$2,176
	Intangible Assets	$1,534	$0	$1,534
	FHLB Stock	$3,469	$0	$3,469
	Accrued Interest Receivable	$3,114	$0	$3,114
	Other	$14	$0	$14
	Total	$10,307	$0	$10,307
14G	TOTAL ASSETS	$385,751	$16,752	$368,999
	LIABILITIES:			
15G	Total Deposits	$357,240	$0	$357,240
16G	FHLB Advances	$0	$0	$0
17G	RTC Advances	$0	$0	$0
18G	Secured Borrowings	$45,000	$0	$45,000
19G	Secured Liabilities	$78	$0	$78
20G	Unsecured Borrowings	$0	$0	$0
21G	Accrued Other Expenses	$515	$0	$515
22G	Other Liabilities	$6,819	$0	$6,819
23G	Total Liabilities	$409,652	$0	$409,652
24G	Net Worth	($23,901)	$16,752	($40,653)
25G	TOTAL LIABILITIES & EQUITY	$385,751	$16,752	
26G	Gross Cash to Acquiror	NA	NA	$40,653
	Plus RTC Advances	NA	NA	$0
	Gross RTC Funding	NA	NA	$40,653

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Notes:

REPORT G continued 24-Sep-90 06:41 PM
FIN: 8281
OPTION: WHOLE BANK

	MEMO ITEMS:	
27G	General & Specific Reserves	$2,239
28G	Total Deposits <$80,000	$329,075
29G	Brokered Deposits <$80,000	$0
30G	Total Brokered Deposits	$0
31G	Secured Deposits	$0
32G	Preferred Deposits	$95
33G	Insured Deposits	$356,790
34G	Uninsured Deposits	$355
35G	Preferred Liabilities	$5,602

36G ESTIMATED LOSS IN CONTINGENT & NON-BOOKED LIABILITIES:

Secured Borrowings	0
Secured Liabilities	0
Total Secured	$0
Unsecured Borrowings	0
Unsecured Accrued Expenses	0
Unsecured Other Liabilities	0
Total Unsecured	$0

37G NON-BOOKED ASSETS:

- Cash & Securities	0
- Residential Loans	0
- Consumer Loans	0
- Other Loans	0
- Real Estate Owned	0
- Other Assets	0
Total	$0

38G	# of Branches	5
39G	# of Deposit Accounts	62,422
40G	RTC M-T-M Loss	$21,633

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Notes:

ATTACHMENT 2

ACCOUNTING CLAIMS
(Big Six)

DAMAGES
(Approximate figures)

COOPERS & LYBRAND

Institution: First Federal S&L, OK
Freedom FS&L v. First Federal S&L of Shawnee, $7MM
(Coopers & Lybrand),
CIV 87-912
(USDC WD OK)

ARTHUR ANDERSON

Institution: Continental National Bank & Trust Co., IL
The Royal Bank of Canada & Continental Illinois
Bank (Canada) v. Arthur Anderson & Co., $13MM
9587/86
Sup. Court Ontario, Canada

ERNST & YOUNG

Institution: Western Savings Association, TX
FDIC V Ernst & Young & Arthur Young & Co., $560MM
CA-3-90-0490-H
(USDC ND TX)

Institutions: City & County Bank of Anderson, City & County Bank of Knox County, First Peoples Bank of Washington County, United American Bank in Knoxville, TN
FDIC v. Ernst & Whinney, $255MM
CIV-3-87-364
(USDC ED TN)

Institution: Imperial Savings Association, CA
RTC as Conservator for Imperial Savings v.
Ernst & Whinney, $26MM
90-0374-JLI
(USDC SD CA)

PEAT MARWICK MAIN

Institution: Continental Illinois National Bank & Trust Co., IL
FDIC v. Main Hurdman, $60MM**
CIV-S-85-552(LKK)
(USDC ED CA)

Institution: Duvall FS&L, FL
RTC as Conservator for Duvall FS&LA v.
Peat Marwick, $16.6MM
89-085-48 CA
(4th Jud. Cir. Ct.)

DELOITTE, HASKINS & SELLS (Merged with Touche Ross)

Institution: Sunrise S&L, FL
FDIC v. Jocaby, et al., $250MM
(Deloitte, Haskins & Sells)
MDL 655
(USDC ED PA)

Institution: First South, FA, AR
FDIC v. Deloitte & Touche Ross & Co., $400MM
LR-C-90-520
(ED ARK W. Div)

Institution: Commonwealth FS&L, FL
RTC as Conservator for Aspen SB Co. v.
Deloitte, Haskins & Sells et al., $50MM
89-6572-CIV-JCP
(USDC SD FL)

Institution: Royal Palm FS&L, FL
RTC as Conservator for Royal Palm
FS&L v. Deloitte, Haskins & Sells, Amount undetermined
89-8039-CIV-PAINE
(USDC SD FL)

J.K. BYRNE (ACCOUNTANTS) (Merged with Touche Ross)

Institution: Crescent FSB, LA
FDIC v. Kevin C. Schoenberger, et al., $40MM
(J.K. Byrne)
89-2765S-L/M-2
(USDC ED LA)

TOUCHE ROSS & CO.

Institution: Beverly Hills S&L, CA
FSLIC v. Dennis Fitzpatrick, $300MM
(Touche Ross & Co.)
CV 88 0651
(USDC CD CA)

Institution: Lee Savings Association, TX
Lee Savings Assoc. v. Touche Ross & Co., $38,600
A-89-CA-116
(USDC WD TX)

Institution: Midwest Federal S&L, MN
Midwest Federal S&LA v. Greentree $192MM
Acceptance Inc., et al.,
(Touche Ross & Co.)
3-88-669
(USDC MN)

Institution: Peoples Federal, OK

RTC as Conservator for People's Federal v. Touche Ross & Co., et al., $467M
90-C-221-B
(USDC WD OK)

**A verdict of $15 million is being appealed.

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